

**BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE**

July 31, 2009

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

BRIEF OF CHATTANOOGA GAS COMPANY

**I.
Preliminary Statement**

The Tennessee Regulatory Authority ("TRA" or "Authority") convened this contested case proceeding so that the Consumer Advocate and Protection Division of the Office of Attorney General and Reporter ("CAPD") could litigate its perceived issues regarding Chattanooga Gas Company's ("CGC" or "Company") gas supply, capacity planning, and asset management. Accordingly, the CAPD had the burden of proof on the substantive issues in this docket. However, after approximately two (2) years of litigation in this proceeding, including propounding and receiving discovery responses to over 226 data requests, CAPD has failed to meet that burden. In fact, on the issues of gas supply and capacity planning, CAPD submitted no evidence at all. On the issues of asset management, the CAPD submitted limited evidence which was discredited at trial through cross-examination and the responsive testimony of CGC.

Now, after failing to meet its burden of proof in this lengthy and expensive proceeding, CAPD is seeking to have the TRA order further proceedings on a structured timeframe and with a mandatory requirement that outside consultants be hired by the

TRA. (Tr. 91). Indeed, it is the CAPD's testimony in this case that an outside consultant can do a better job of reviewing such issues than the TRA. (Tr. 100). The CAPD could have hired a consultant in this proceeding but chose not to do so. The review process the CAPD seeks in this proceeding is more rigid and structured than the optional review process proposed in the settlement agreement. The TRA denied the proposed settlement agreement on the basis that "[i]t simply attempts to impose strict requirements on the Authority as well as establishing arbitrary procedures, processes and timelines." (Tr. 26). The Authority also noted that "[i]t is well within the Agency's discretion to open a contested case and order an evaluation and report on the prudence of CGC's gas supply plan, asset management, RFP process, and IMCR filings." (Id.). CGC respectfully recommends that the TRA deny CAPD's request for the same reasons stated by the Authority in denying the proposed Settlement Agreement.

While CGC did not have the burden of proof in this proceeding, the evidence submitted by CGC made clear that the amount and mix of its gas supply and capacity assets are appropriate and reasonable to serve the demands of its customers on the coldest days of the year. Further, the evidence submitted by the Company plainly demonstrated that the Authority's current reporting and review process regarding the Annual Cost Adjustment ("ACA"), Performance Based Ratemaking ("PBR"), and Interruptible Margin Credit Rider ("IMCR") for CGC, along with the Authority's existing ability to order further review or a contested case when it deems necessary, provides sufficient oversight of gas supply, capacity planning, and asset management issues, without the need for the rigid review frequency and structure proposed by the CAPD. The Company's evidence also confirmed that the TRA Staff is knowledgeable and competent

regarding these issues and that the TRA has previously established further safeguards by approving a Request for Proposal ("RFP") process for Asset Management and Affiliate Transaction Guidelines to be followed. Finally, the Company's evidence proved that the current Asset Management RFP procedures are appropriate and that the hybrid compensation arrangement consisting of a minimum annual guaranteed amount and a 50/50 sharing is reasonable and is returning significant value to CGC's customers.

Accordingly, as more fully set forth below, CGC respectfully recommends that the TRA conclude this proceeding and enter a Final Order that includes ordering paragraphs in substantially the following proposed form:

"IT IS THEREFORE ORDERED THAT:

1. The Authority's current reporting and review process regarding the ACA, PBR, and IMCR for CGC, along with the Authority's existing ability to order further review or contested cases when it deems necessary, provides sufficient oversight of gas and capacity supply and asset management issues and the Authority declines to adopt the rigid review frequency and structure proposed by the CAPD.
2. The evidence presented by CGC in this proceeding shows that the amount and mix of its capacity supply assets are appropriate and reasonable to serve the demands of its customers on the coldest days of the year.
3. The current Asset Management RFP procedures as reflected in CGC's tariff approved by this Authority are sufficient to ensure that the bidding process is fair and reasonable and that fair market value is

received from the successful bidder for the right to optimize CGC's fallow assets, and the Authority declines to adopt any revisions to said procedures or processes.

4. The Asset Management hybrid compensation arrangement consisting of a minimum annual guaranteed amount and a 50/50 sharing is reasonable and has returned significant value to CGC's customers and the Authority declines to adopt any changes.

5. The Authority declines to revise the affiliate guidelines set forth in CGC's tariff as previously approved by the Authority.

6. The Authority shall allow CGC's request for cost recovery in this proceeding of prudently incurred litigation costs through the PGA with such costs to be apportioned equally through the next three (3) ACA filings. CGC shall file documentation of its costs with the Authority within sixty (60) days of the date of this order."

II. Procedural Background

This docket was opened as a result of the CAPD's attempts to litigate certain issues related to asset management and capacity release during CGC's last rate case (Docket 06-00175).¹ During the regularly scheduled Authority Conference on January

¹ In Docket 06-00175, these issues were bifurcated into Phase II to be addressed after the resolution of the Phase I ratemaking issues. The parties to that docket reached a proposed settlement agreement, addressing all issues related to ratemaking including rate design, which was adopted by the TRA during a regularly scheduled Authority Conference on December 5, 2006. (See Transcript of Proceedings, p. 14 (Dec. 5, 2006 in Docket 06-00175)). On May 18, 2007, the Company requested that the TRA close Phase II of Docket 06-00175 and allow the issues pertaining to capacity planning and asset management to be considered in the annual ACA audit docket. At the regularly scheduled Authority Conference on July 9, 2007, the TRA voted to close Phase II of Docket 06-00175 and, as the recent audit docket had been concluded, to open a separate docket to address matters raised by the CAPD related to asset management and capacity release. (See Order Closing Phase II of Docket (filed Dec. 17, 2007 in TRA Docket 06-00175)).

14, 2008, the TRA voted to convene a contested case proceeding to address the CAPD's issues regarding CGC's gas supply and capacity planning and asset management and to appoint the TRA's General Counsel or his designee to act as the Hearing Officer for purposes of establishing an issues list and procedural schedule and preparing the matter for hearing. (See Order (Jan. 25, 2008)).

Issues List

On March 17, 2008, the Hearing Officer established the Issues List for this docket. The issues are set forth below in a reorganized format according to topical categories. (See Order Setting Issues List, Exhibit A (March 17, 2008)).

Gas and Capacity Supply

3. How is a FERC-mandated payment accounted for, and is it fair to consumers?
4. What is the appropriate level and mix of firm transportation, peaking, and storage capacity?
5. Has CGC oversubscribed to storage and transportation capacity assets to handle its jurisdictional requirements?
6. What safeguards should exist to ensure CGC subscribes to the proper levels of capacity?
7. Have CGC's storage injections been prudent with regard to timing and cost?
8. Have CGC's sales and purchases of natural gas been prudent and should safeguards be put in place to ensure least cost purchasing of natural gas? If so, what should these safeguards be?
9. Is CGC currently utilizing its gas storage assets to maximize benefits to ratepayers?
12. What regulatory approval should occur in the event that assets are added or removed from the asset mix set forth in the asset management agreement? What affiliate guidelines should be in place if those removed assets are subsequently purchased by an affiliate or parent company?

Asset Management of Fallow Assets

1. Should the current CGC sharing mechanism for profits from the sale, lease, or release of capacity and any other gas supply assets, be revised? If so, how?
2. Is the current bidding process fair and reasonable?
10. Is the amount paid by Sequent for the right to utilize or market assets, which are paid for by the customers of CGC, representative of the fair market value of such assets?
11. Is it proper to impute to CGC all or a portion of the profits Sequent generates through its management of CGC's idle gas supply assets and excess capacity?
14. If CGC were to engage in asset management itself, how should the Tennessee Regulatory Authority monitor CGC's asset management activities?

Affiliate Transaction Guidelines

13. Are the current affiliate guidelines sufficient? If no, in what way(s) should they be amended?

CGC's Litigation Cost Recovery

15. Should CGC be able to recover litigation costs incurred as a result of its participation in this docket from ratepayers in the future?

CGC's Motion to Dismiss

On April 8, 2008, CGC filed a motion to dismiss the claims and issues set forth in the Issues List asserted against it by the CAPD for failure to state claims upon which relief can be granted. CGC asserted that the issues raised by the CAPD had already been settled in previous dockets (Dockets 04-00402, 05-00321, and 08-00012) and thus should not be re-litigated. (See CGC Motion to Dismiss (April 8, 2008)). CGC argued that the TRA had been doing its job and protecting the ratepayers of CGC by reviewing and taking action concerning CGC's gas supply assets and asset management arrangements through CGC's annual ACA and PBR audits. (Id. at 1, 14-15).

The CAPD filed a response in opposition to CGC's Motion to Dismiss on April 22, 2008. (See CAPD's Response (April 22, 2008)). After hearing oral argument at the

regularly scheduled Authority Conference on May 19, 2008, the TRA panel denied CGC's motion to dismiss, and the contested case proceeded. (See Order Denying Motion to Dismiss (June 20, 2008)).

Discovery and Pre-Filed Testimony

The original procedural schedule provided for three rounds of discovery. (See Order, at Exhibit A (Feb. 19, 2008)). The CAPD was entitled to seek discovery before filing its pre-filed direct and rebuttal testimonies. CGC was entitled to seek discovery before filing its pre-filed responsive testimony. The CAPD served not less than 226 discovery requests on CGC, most of which addressed the gas and capacity supply planning issues. (See Order on Third Round Discovery Disputes, at 45 (May 21, 2009)). Each round of the CAPD's discovery resulted in the CAPD filing motions to compel against CGC and the Hearing Officer resolving the discovery disputes after allowing the parties to brief and orally argue the issues at status conferences.

On May 30, 2008, the CAPD filed the direct testimony of Terry Buckner and Dr. Stephen Brown. Mr. Buckner's testimony addressed the asset management issues, and Dr. Brown's testimony addressed the gas and capacity supply planning issues.

On July 30, 2008, CGC filed the testimony of Tim Sherwood in response to the CAPD's pre-filed direct testimony.

On October 13, 2008, the CAPD filed the rebuttal testimony of Dr. Stephen Brown addressing gas and capacity supply planning issues.

CGC's Motion to Strike Portions of Dr. Brown's Testimony

On December 2, 2008, CGC filed a motion to strike the portions of Dr. Brown's direct and rebuttal testimony that inappropriately relied on hearsay. (See CGC's Motion

to Strike and Objections to Portions of Dr. Brown's Direct and Rebuttal Testimony, at 1-2 (Dec. 2, 2008)). CGC requested that approximately thirteen sections of Dr. Brown's pre-filed direct and rebuttal testimony that contained hearsay be excluded as being unreliable and failing to meet the evidentiary standard set forth in the Tennessee Rules of Evidence or Tenn. Code Ann. § 65-2-109. (Id. at 3-4). Additionally, CGC argued that Dr. Brown raised for the first time in his rebuttal testimony three new issues and arguments that were procedurally improper for rebuttal testimony. (Id. at 5). CGC requested that it be allowed to address and refute these new concerns, assertions, and opinions of Dr. Brown through sur-responsive testimony of Tim Sherwood. (Id.).

The CAPD responded to CGC's motion to strike Dr. Brown's testimony, arguing that Dr. Brown's reliance on hearsay was appropriate and that it satisfied the standards for expert testimony as set forth in Tenn. Rule of Evid. 702 and 703. (See CAPD's Response, at 2-3 (Dec. 5, 2008)).

CGC filed a reply to the CAPD's response and contended that the CAPD had misplaced its reliance on the expert witness rule of Tenn. R. Evid. 703 and had not provided the requisite foundation for using the type of hearsay incorporated into Dr. Brown's testimony. (See CGC's Reply, at 2 (Jan. 27, 2009)). CGC explained that the CAPD could not demonstrate the proper foundation because:

Experts in the field of gas supply and capacity planning and asset management would not reasonably rely on the type of piecemeal hearsay statements and materials upon which Dr. Brown is attempting to base his testimony. Rather, experts in the field of gas supply and capacity planning and asset management would rely upon actual data involving CGC's assets and would perform analysis to determine firm design day requirements and load duration curves at a minimum.

(Id.). CGC further asserted that the CAPD failed to provide any evidence about the hearsay testimony for the TRA to make a determination about its underlying trustworthiness. (Id. at 3). CGC recommended that the CAPD be required to separate Dr. Brown's substantive testimony from his exhibits. (Id. at n.1). CGC also questioned whether Dr. Brown was qualified to testify as an expert on these matters and pointed out that his testimony was not based on relevant facts, processes, or data regarding CGC's asset management or gas supply and capacity planning but rather upon Dr. Brown's speculations. (See id. at 4).

Pre-Hearing Filings and December 2008 Pre-Hearing Conference

Prior to the then-scheduled December 15, 2008 hearing on the merits, CGC submitted, pursuant to the procedural schedule, the exhibits that CGC planned to use during the December 15, 2008 hearing on the merits for the direct and re-direct of its witness. (See CGC's Filing of Exhibits (Dec. 1, 2008)). The CAPD objected to the exhibits and moved to exclude CGC's hearing exhibits, claiming that the exhibits were an attempt at sur-rebuttal. (See CAPD's Objection and Motion to Exclude (Dec. 3, 2008)). CGC replied that the exhibits were necessary to refute the improper rebuttal testimony of Dr. Brown which raised new concerns not previously addressed in either Dr. Brown's or Mr. Sherwood's prior pre-filed testimonies and were proper for the TRA to review and assess the weight of the evidence presented. (See CGC's Reply (Dec. 5, 2008)).

At the December 8, 2008 pre-hearing conference, the parties represented to the Hearing Officer that an agreement-in-principle had been reached and requested that the hearing be postponed so that the parties could focus their efforts on filing their proposed settlement agreement. No oral argument on the outstanding motions was presented to the

Hearing Officer. On December 9, 2008, the Hearing Officer granted the parties' request and postponed the hearing on the merits. (See Notice of Cancellation of Hearing (Dec. 9, 2008)). After failed attempts to reduce the agreement-in-principle into a proposed settlement agreement, CGG filed a status report as ordered by the Hearing Officer and requested that dates be established for a status conference to resolve all outstanding motions and for the hearing on the merits. See CGC's Status Report (Dec. 19, 2008).

**Hearing Officer's Order Directing Dr. Brown to
Re-Format and Re-File Testimony**

With the failure of settlement discussions, the Hearing Officer conducted a status conference on February 9, 2009 to address CGC's motion to strike the hearsay portions of Dr. Brown's testimony. The Hearing Officer struck Dr. Brown's direct and rebuttal testimony and ordered that his direct and rebuttal testimony be re-formatted and re-filed to remove the objected-to quotations, documents, and materials embedded in his substantive testimony and replace them with complete and proper citations. (See Order, at 24-26 (March 2, 2009)). Dr. Brown was also ordered to attach as exhibits complete copies of all documents from which he extracted quoted materials as well as all orders entered and associated with the quoted materials. (Id. at 25).

**Amended Procedural Schedule to Add Fourth Round
Of Discovery and Additional Testimony**

Additionally, the Hearing Officer amended the procedural schedule as requested by the parties to allow (1) CGC to file testimony addressing the new issues raised in Dr. Brown's rebuttal testimony and explaining the exhibits filed by CGC on December 1, 2008, (2) a fourth round of discovery by the CAPD, and (3) Dr. Brown to file sur-rebuttal

testimony. (Id. at Exhibit B). The hearing on the merits was subsequently scheduled for July 13, 2009.

On April 1, 2009, CGC filed sur-responsive testimony of Tim Sherwood. The CAPD served a fourth round of discovery requests on CGC, all but one request which was denied by the Hearing Officer addressed gas supply and capacity planning issues. CGC objected to several of the CAPD's discovery requests in part for having already been denied by the Hearing Officer during the CAPD's first round of discovery. The CAPD filed a motion to compel CGC to respond to all of the fourth round discovery requests and to compel CGC to respond to objections previously upheld by the Hearing Officer concerning certain first round discovery requests. After determining that the CAPD had presented no evidence of changed circumstances, the Hearing Officer upheld her previous rulings regarding first round discovery requests. (See Order on Third Round Discovery Disputes (May 21, 2008)). CGC responded to the fourth round of discovery requests as directed by the Hearing Officer. The CAPD moved for an interlocutory review of the Hearing Officer's May 21, 2009 Order concerning discovery. After hearing oral argument, the TRA panel voted to uphold the Hearing Officer's well-reasoned Order. On June 10, 2009, the CAPD filed Dr. Brown's sur-rebuttal testimony.

CGC's Motion to Exclude Dr. Brown's Testimony

On June 22, 2009, CGC filed a motion to exclude Dr. Brown as an expert from testifying in the field of gas supply and capacity planning. (See CGC's Motion to Exclude (June 22, 2009)). The CAPD filed a response in which it admitted that Dr. Brown was not an expert in gas supply and capacity planning but rather was being submitted as an expert in regulatory economics. (See CAPD's Response, at 3 (June 25,

2009)). After hearing oral argument, the Hearing Officer took the arguments under advisement to issue a written ruling.

CAPD Withdraws Dr. Brown's Testimony

Before the Hearing Officer issued that order, the CAPD filed notice on July 2, 2009 of its withdrawing of all of Dr. Brown's testimony. (See CAPD's Notice of Withdrawal of Dr. Steve Brown as a Witness (July 2, 2009)).

Proposed Settlement Agreement

On July 8, 2009, the parties filed with the TRA a proposed settlement agreement to resolve all issues raised in the docket. Prior to proceeding with the hearing on the merits on July 13, 2009, the TRA panel considered the parties' proposed settlement agreement. Chairman Kyle moved that the proposed settlement be denied finding that:

After thoroughly reviewing the proposed 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 prudence 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."

(Tr. 25-26 (emphasis added)). The panel unanimously agreed to deny the proposed settlement agreement and proceed with the hearing on the merits. (Tr. 26-27). The hearing concluded on July 13, 2009.

III. Argument and Citation to Authority

A. The TRA's Current Review Processes and Authority are Sufficient to Provide Appropriate Oversight of Gas Supply and Capacity Planning and Asset Management.

Pursuant to the Purchased Gas Adjustment Rule 1220-4-7, the TRA performs annual reviews and audits of the gas costs associated with a gas utility's gas and capacity supply assets and the related revenues, including revenues generated from non-jurisdictional use of these assets. The PGA Rule defines "gas costs" to include all costs of gas, including costs associated with the purchase, storage, or pipeline transportation of gas for a company's system supply. (See Rule 1220-4-.01(1)). In its annual ACA and PBR audits, CGC is required to submit to the TRA the invoices associated with its gas costs so that the TRA Staff can determine whether the gas costs, including the costs associated with its pipeline transportation capacity and storage, that are charged to the customers are appropriate and prudent as well as determine that the customers are receiving the proper credits for any over-recoveries of cost, gas cost refunds, and the gains generated by CGC's asset manager. The Company is also required annually to make its IMCR filing to verify the gross margin that has been generated from the use of CGC's gas and capacity supply assets that are shared with its customers. Although the IMCR and the PBR are separate filings, the Staff conducts a joint review and issues an audit report that addresses both filings.²

Mr. Sherwood testified that the TRA and its staff currently review and audit gas purchase information and capacity planning through the ACA and PBR filings. (Tr. 164-

² For example, see the April 8, 2009 Order and Audit Report Docket 08-00207 –Chattanooga Gas Company Annual Incentive Plan Filing for the Twelve Months Ended June 30, 2008.

165). Mr. Sherwood also testified that the TRA staff has exhibited an understanding of these issues in their review and audit of such filings. (Tr. 186-188). The TRA already has the authority to order a further review or a contested case if the TRA determines such actions are warranted in a specific review. Accordingly, the current TRA procedures and processes are more efficient and cost-effective than establishing a rigid requirement that outside consultants always will be hired to conduct review of gas supply and capacity requirements filings. This is especially true given the fairly static nature of CGC's gas supply and capacity requirements. (See Tr. 171-172).

While Nashville Gas and the CAPD negotiated a settlement agreement between themselves that requires triennial reviews of certain issues related to Nashville Gas' incentive plan to be performed by an independent consultant at the ratepayers' expense, the same rigid review process does not make sense for CGC which is a much smaller LDC than Nashville Gas and has fairly modest growth that makes rigid review requirements costly to the ratepayers with not much benefit. CGC does not have an incentive plan like Nashville Gas. The Nashville Gas settlement with the CAPD dictates a more rigid process than even the proposed settlement in this case which was rejected by the TRA because the TRA has current processes that are sufficient to conduct such reviews. Allowing the existing review processes to continue will better protect CGC's customers and ensure that they continue to receive credits from the gains generated by the asset manager as offsets to the high cost of gas rather than spending the credits to pay for unnecessary additional reviews that will provide no additional protections. The CAPD offered only mere opinion, without proof or analysis, for its proposition that the cost of a rigid process of retaining an outside consultant would result in greater protection to

customers of CGC than already provided by the TRA in its current processes. Thus, the Authority should decline to adopt the rigid review frequency and structure proposed by the CAPD based on the same reasons stated by the TRA for denying the proposed settlement.

B. The CAPD Has Failed to Meet Its Burden of Proof Regarding the Gas and Capacity Supply Issues.

The CAPD has the burden of proof regarding gas supply and capacity requirements issues set forth as issue numbers 3 through 9 on the Issues List for this docket. However, as the record shows, the CAPD has failed to provide any evidence regarding these issues. The only evidence in this docket regarding gas supply and capacity requirements is the testimony and data provided by CGC's expert Mr. Tim Sherwood. Mr. Tim Sherwood has provided reliable evidence and data to support the finding that CGC has the appropriate amount of gas supply and capacity assets to meet the demands of its firm customers on the coldest days of the year, that CGC's capacity supply planning process is working and is prudent, and that the TRA's current review procedures for gas supply and capacity requirements are working appropriately to protect the customers of CGC.

1. CAPD has failed to meet its burden of proof to justify any changes to the Authority's current review procedures and processes for gas supply and capacity related issues. In fact, CAPD submitted no evidence at all on those issues in this proceeding.

While the CAPD has the burden of proof regarding the gas supply and capacity planning issues, the CAPD has put forth no evidence regarding these issues. Thus, the CAPD has failed to meet its burden of proof to justify any changes to the TRA's current

review process for gas supply and capacity related issues or to justify making changes to CGC's current gas supply and capacity asset array.

On July 2, 2009, when the CAPD withdrew the testimony of Dr. Brown which was the CAPD's only testimony addressing gas supply and capacity issues, the CAPD forfeited its chance to prevail on these issues. Mr. Buckner admitted at the hearing on the merits that his testimony does not address the issues regarding gas supply and capacity requirements. (Tr. 59). Mr. Buckner has provided no testimony or analysis about whether CGC has the appropriate amount of gas supply or capacity assets to meet the demands of its approximately 62,000 customers on the coldest days of the year, whether CGC's capacity planning process is working and is prudent, whether CGC has an appropriate mix of types of capacity (i.e., pipeline transportation capacity, storage capacity, and peaking facilities), or whether a change to the TRA's current review process for gas supply and capacity requirements is justified.

Rather, Mr. Buckner has only provided the TRA with the CAPD's unsubstantiated belief that the TRA Staff has limited expertise on reviewing gas supply and capacity requirements issues and thus needs the assistance of a third party independent reviewer to perform these regulatory functions. (Tr. 93). However, the CAPD has not commented or participated in any of the annual review processes that the TRA currently conducts through the annual ACA audit, the PBR audit, or IMCR filings. The CAPD has provided the TRA with no substantive evidence or testimony as to how the TRA's current review processes are not working or why specifically the Staff needs the assistance of an independent reviewer to perform its functions related to gas supply

and capacity requirements. For the reasons stated in Subsection (A) above, CAPD's belief is without merit.

2. CGC Has Proven that Its Gas Supply and Capacity Planning Are Appropriate and Reasonable to Meet Firm Customer Load Demands.

While the CAPD had the burden of proof in this proceeding and failed to produce any evidence regarding CGC's current gas supply and capacity planning, CGC did present evidence as to its analysis of the customer demand requirements on its system and the appropriate amount and mix of gas supply and capacity assets to meet the requirements. Mr. Sherwood testified that load forecasting, pipeline transportation capacity, storage service levels, peaking capability requirements, daily supply resource management, and system monitoring are functions that are performed by AGL Services Company employees, working exclusively for the LDC's of AGL Resources Inc., including CGC. (Sherwood Pre-filed Testimony (July 30, 2008), at 2). The capacity planning objective of CGC was described to be meeting the gas supply needs of its firm service customers under the coldest weather conditions that can reasonably be expected to occur in the service territory. (*Id.*).

Mr. Sherwood testified that the Company begins its analysis of the firm customer demand by projecting the design day usage of firm customers. (*Id.* at 3). The term design day means for planning purposes one of the coldest days expected in the service area based on historical observations. (*Id.* at 7). The evidence demonstrated that a design day temperature mean of 8 degrees F had previously occurred on the system during three winter periods within the recent historic data set and that based on those historic observations the 8 degree design day temperature used by CGC is reasonable. (*See* Tr. 146; Exhibit 22).

According to Mr. Sherwood's testimony, the Company determines the maximum daily firm load on the system by performing a number of statistical analyses using actual historical customer load data under actual weather conditions to establish a load to temperature relationship on a per customer basis. The design day load forecast is then determined based on this relationship using the projected number of customers and the design day temperature. As well, a similar analysis is performed to project the heating season and full year load patterns in order to determine the appropriate gas supply and capacity asset portfolio for the CGC system. (Tr. 147).

The evidence provided by CGC plainly showed that the bend regression analysis conducted by the Company produced the best fit with the historic data set and was the appropriate methodology to determine the firm load to temperature relationship. (See Tr. 143; Exhibit 15). Based on the Company's analysis, the projected design day firm customer load was shown to be 129,761 Dth. (See Tr. 152-153; Exhibit 10). The Company has provided for design day deliverability of 138,917 Dth to meet that projected firm customer demand which allows for a 7 percent reserve margin. (Id.). Mr. Sherwood testified that a reserve margin in that range was fairly typical but that a higher reserve margin could be justified based on the contingency risk associated with having such a large amount of the deliverability depending on the LNG facility. (Tr. 152-153).

In addition to the on-system LNG facility, Exhibit 10 provided the portfolio of interstate capacity assets utilized by CGC to provide the required deliverability to the system. The portfolio includes firm interstate transportation capacity on Southern Natural Gas Company and East Tennessee, as well as, interstate storage capacity on Southern Natural Gas and Tennessee Gas pipeline. The Company's portfolio of capacity

assets is reasonable and appropriate to serve the system load as evidenced by the CGC Load Duration Curve provided in Exhibit 13.

Regarding gas supply, Mr. Sherwood testified that his group on behalf of CGC establishes the daily system demand. (Tr. 154). They also determine the appropriate mix of gas purchases between base-load purchases for the month and daily purchases. (*Id.*). His group determines when it is necessary to use storage gas or LNG and over which pipeline gas is to be transported to the system. (Tr. 154-156). The factors used in making these decisions include the operational deliverability, the operational flexibility, and the overall price effect to the customer. (Tr. 155-156). As noted in Subsection (A) above, the TRA's current processes and procedures provide for the review and audit of the gas supply and capacity activity and decisions through the ACA, PBR, and IMCR filings.

C. The CAPD Has Failed to Meet Its Burden of Proof Regarding the Asset Management Issues.

The CAPD has the burden of proof regarding all asset management issues that are being litigated in this docket. As explained below, the CAPD has not provided sufficient evidence to support the changes or remedies that the CAPD is seeking.

1. The current RFP procedures in CGC's Tariff are fair and reasonable, and the CAPD has failed to meet its burden to justify changes to the existing approved RFP procedures.

The CAPD has not provided any evidence sufficient to meet its burden to justify changing CGC's existing RFP procedures set forth in its Tariff and approved by the TRA. On the other hand, CGC has provided evidence that its existing RFP procedures are fair, reasonable, and transparent so that reviewers can clearly determine the winning

bidder. The weight of the evidence supports a finding that CGC's current RFP procedures have worked properly to ensure that CGC's customers are receiving a fair return on CGC's fallow gas supply assets used in non-jurisdictional transactions.

CGC followed the approved RFP procedures set forth in its Tariff when it issued the RFP for its current asset management agreement in November 2007, when it evaluated the bids received, and when it selected the winning bidder. CGC filed its new asset management agreement with the TRA for approval in Docket 08-00012. The CAPD intervened in Docket 08-00012 which the TRA convened as a contested case to address whether CGC had complied with the RFP procedures in its Tariff in bidding and awarding the asset management agreement and whether the asset management agreement should be approved for the benefit of CGC's customers. Through CGC's filings in that docket, it was clear that there were significant differences in the first and second place bidders. (Tr. Exhibit 6 & 7). The second highest bidder's annual guaranteed minimum was 70% less than the winning bidder's guarantee. (Tr. Exhibit 7). Based on the transparency of the bidding process, there could be no doubt that the correct winning bidder was selected. In fact, the CAPD did not take a position in Docket 08-00012 that CGC had not followed the RFP procedures or that CGC had not selected the appropriate bid. In Docket 08-00012, the TRA approved CGC's current asset management agreement award as being in the best interests of CGC's customers.

Mr. Buckner testified in the current docket that "the RFP procedures are good." (Tr. 51). However, Mr. Buckner contends that "it's somewhat ambiguous regarding how the contract was negotiated by the parties between the asset manager and CGC." (Id.). He argued that the evaluation process needs to be more transparent and objective. (Id.)

Mr. Sherwood clarified that the structure of the RFP was not by happenstance and that that the RFP "was not negotiated with Sequent prior to doing the bids." (Tr. 162).

Mr. Sherwood explained that Sequent never saw the RFP before it was issued. (Id.).

Our RFP package included the cover letter, the process by which we were going to evaluate bids, a list of what the assets were, and even the contract that they were going to have to sign. That was not the contract that Sequent was currently in. Sequent saw a new contract just like all the other bidders did when the contract went out.

(Tr. 163).

Mr. Sherwood testified that the terms of the RFP including the hybrid compensation arrangement were well thought out by CGC's gas supply planning personnel. (Tr. 162-163). CGC decided to include a set sharing arrangement rather than a fixed fee arrangement in its RFP for the current asset management agreement so that CGC's customers would have the opportunity to share in the significant value that is created during times when there are disruptions in the marketplace such as in the aftermath of Hurricane Katrina. (Tr. 159-160). CGC also decided to require bidders to include an annual guaranteed minimum amount in their bids so that the Company could clearly evaluate and determine the winning bidder and also guarantee a minimum level of value that would be returned annually to its customers. (Tr. 160-161).

As Mr. Sherwood explained, if the bidders were allowed to bid different sharing percentages, it would have been impossible to determine which entity would actually return the greatest value to CGC's customers because one bidder who bids 50% sharing and is particularly good at asset management could return \$10 million while another bidder who bids 70% sharing could return only \$5 million. (Tr. 161). Evaluating bids based on different sharing percentages provides no insight into the potential value that

may be returned to the customers and would produce an arbitrary evaluation. CGC's goal in evaluating and awarding the contract was to obtain the most value and money for its customers. (Tr. 164).

Through his testimony, Mr. Sherwood also highlighted potential dangers associated with weighting the evaluation criteria as advocated by the CAPD. Mr. Sherwood explained that the second highest bidder's financial backer went bankrupt six months after CGC's bid process closed. (Tr. 163-164). The second highest bidder's financial backer had a higher financial rating than Sequent's financial backer, so if CGC had placed a disproportionate weight on financial rating, it could have possibly resulted in awarding the contract to someone other than the highest bidder and CGC's customers would have been terribly disadvantaged in not receiving the highest annual guaranteed minimum. (Tr. 164; Exhibit 7).

Additionally, CGC's RFP procedures ensure that fair market value will be paid by the winning bidder for the right to optimize CGC's fallow assets. The RFP process by its very nature of placing the request for proposals to manage CGC's identified assets out into the market and receiving bids from the market results in the determination of what the market perceives is the fair value for use of CGC's fallow gas supply assets. (See Tr. 159).

CGC's current bidding process is fair and reasonable and ensures that the evaluation of the bids received is transparent and reviewable by the TRA. The RFP process also ensures that the fair market value is being paid by the winning bidder. The weight of the evidence pending before the Authority supports a finding that CGC's

current RPF process is fair and reasonable. The CAPD has failed to meet its burden of proof to justify making changes to CGC's current RFP process.

2. CGC's asset management hybrid compensation arrangement consisting of an annual guaranteed minimum and 50/50 sharing is reasonable and has created significant value for CGC's customers. The CAPD has failed to meet its burden of proof to justify changing the hybrid compensation arrangement.

Since 2004, the sharing arrangement in CGC's asset management agreements has returned approximately \$14 million to CGC's ratepayers. (Tr. 61; Exhibit 2). This is a very favorable return especially in light of the small size of CGC (which serves approximately 62,000 firm customers). The CAPD has agreed that CGC's return to its customers has been good. (Tr. 62).

Mr. Buckner testified that the compensation produced by CGC's asset management agreement compares favorably to its sister affiliate LDCs and to the two other major LDCs in Tennessee. (Tr. 88-89; Buckner Pre-filed Testimony, at 10). Mr. Buckner's testimony supporting his proposed change in the sharing percentage is based on the alleged national comparison that he performed of other asset management agreements. (See Buckner Pre-filed Testimony, at 14). Mr. Buckner admitted that he did not conduct a 50 state survey and that his comparison only consisted of pointing out higher sharing percentages of other asset management arrangements that exist in the nation without analyzing the value that has actually been returned in those other situations. (Tr. 98, 114). Mr. Buckner admitted that there was nothing "broken" with CGC's current asset management agreement or the sharing being returned to CGC's customers. (Tr. 90).

The CAPD's comparison to other asset management agreements in the nation fails to account for differences in the agreements, including who pays for the overhead. Mr. Buckner admitted that he had not reviewed any of the asset management agreements upon which his comparison is based due to the fact that they are confidential. (Tr. 91, 98-99). This would also be a problem for an independent reviewer who would also not be able to obtain copies if the Attorney General and Reporter of the State of Tennessee is unable to obtain copies. (See Tr. 115).

While Mr. Buckner has referenced different sharing percentages from orders of other commissions to support his position, Mr. Buckner failed to review the actual amount of the value that has been shared with the customers. (Tr. 114). Mr. Buckner failed to review the terms of the referenced asset management agreements that explain how the value to be shared is calculated which is critical. (Tr. 114-115). For example, Mr. Buckner admitted that he had not realized that, in the Indiana Order and Settlement Agreement that he relied upon in his pre-filed testimony, the asset manager deducts its overhead from the total gain generated before it is shared with the ratepayers. (Tr. 103-104, 111-110). Mr. Buckner admitted that CGC's asset manager Sequent deducts its overhead from its share of the gain which results in a greater return to the customer. (Tr. 105). Sequent bears all of the risk associated with generating the gain, not CGC's customers. (Tr. 106). This is a significant difference that might result in a higher sharing percentage but may not generate greater value for customers compared to a lower sharing percentage with overhead being deducted from the asset manager's portion after the gain is shared. There are significant overhead costs and risks associated with the asset management business, including hiring highly trained professional to perform the

functions of traders, of the back office, of the mid office, and of the front office; the information systems to conduct trades and derivatives and track the transactions made; the business risk of not being able to generate enough income in the volatile market to offset the significant overhead expenses; and the financial risks associated with the potential non-payment for gas sold on the wholesale market, which the asset manager assumes all risk for and must pay the customers the value of the gain associated with the sale regardless of whether payment is received by the asset manager. (Tr. 166-168). Without taking into account whether overhead or other costs are deducted before or after the sharing, any comparison of sharing percentages is meaningless.

Additionally, Mr. Buckner admitted that there are many variables contained in asset management agreements which make comparison of asset management arrangements difficult. (Tr. 96). These variables or factors must be taken into account before a comparison can be performed. Some of these variables include the size of the service area and the number of the customers, the geographic location of the assets, and whether the LDC retains the ability to perform off-system sales. (Tr. 96-97). Mr. Buckner did not review the asset management agreements used in his comparison and did not account for any of these variables in his comparison. For example, in a close review of the settlement agreement and order in the Indiana case referred to in Mr. Buckner's testimony, ProLiance, the affiliate asset manager, agreed to return approximately \$5 million to the approximately 900,000 customers of the LDCs which equates to approximately \$5.56 per customer. (Tr. 102-103). Significantly, Sequent returned approximately \$2.2 million to CGC's 62,000 customers in the year ending March 31, 2008 which equates to approximately \$35.48 per customer. (Tr. 62-63; Exhibit 2).

The CAPD is asking the Authority to change the sharing percentage of CGC's asset management agreement to 85%/15%. (Buckner Pre-filed Testimony, at 13). However, the CAPD has not explained how this changed sharing percentage will produce greater value for CGC's customers. First, Mr. Buckner admitted that a greater sharing percentage will result in a lower annual guaranteed minimum. (Tr. 61; Buckner Pre-filed Testimony, at 15). Thus, a change in the sharing percentage will not result in the significant annual guaranteed minimum that CGC's customers currently receive. A higher annual guaranteed minimum is extremely important to customers in years when there are not conditions in the market that allow asset managers to generate much value. Additionally, there is no guarantee that the asset manager will produce the same value under a different sharing arrangement. An asset manager will be motivated to utilize the assets for which it has the greater sharing percentage and thus can generate the most revenues. (Tr. 117). Thus, the assets covered by a lower sharing percentage than 50% for the asset manager might not be the first assets to be utilized, especially if the asset manager can retain more money using other equally comparable assets that it also contracts to manage.

While the CAPD's analysis to justify a change in the sharing mechanism is incomplete and fails to account for the many variables and factors that would affect the value that would be shared with the customers under a new sharing formula, CGC explained why its current asset management agreement that includes an annual guaranteed minimum and a set sharing percentage is in the best interests of its customers and ensures that its customers are receiving significant value from the use of the fallow capacity assets. The 50/50 sharing percentage is based on the experience gained by the

personnel of the AGL Services Company through the past asset management arrangements of CGC and its sister affiliate LDCs. (See Tr. 163). It is not an arbitrary percentage. The 50/50 sharing is based on the sharing that was originally allowed for off-system sales, which is the origin of today's asset management industry. (Sherwood Pre-filed Testimony (July 30, 2008), at 16). Based on the \$14 million that has been returned to CGC's 62,000 customers since 2004, experience indicates that this sharing arrangement works to produce significant value.

Additionally, through the annual guaranteed minimum, CGC's customers receive 100% of the value generated until the annual guaranteed minimum is reached. (Tr. 116). Only when two times the annual guaranteed minimum has been generated will CGC's customers begin to receive 50% of the value generated. (Tr. 116). Until that time, they will receive sharing in excess of 50% and potentially greater than 100%. (Sherwood Pre-filed Testimony (July 30, 2008), at 17). CGC's asset management agreement which contains a 50/50 sharing and annual guaranteed minimum is reasonable and has returned significant value to CGC's customers.

Based on the evidence presented at the hearing on the merits, it appears that the CAPD is just using this docket to gain another proceeding with an independent consultant to review CGC's asset management agreement and 50/50 sharing mechanism to recommend changes. (See Tr. 101). Days before the hearing on the merits, the CAPD withdrew its alleged expert witness on gas and capacity supply planning and focused on having the TRA hire an independent consultant to engage in the same review that the CAPD has the burden to perform to justify the changes requested in this docket. Mr. Buckner admitted that the CAPD has not found any wrongdoing by CGC in its capacity

supply planning and asset management agreements. (Tr. 90). Mr. Buckner admitted that it could have hired a consultant to provide the TRA with the testimony that it is asking the TRA to order as a result of this proceeding but did not do so. (Tr. 115). The CAPD stated that the TRA should order the ratepayers instead to pay for such a consultant to perform a review of CGC's asset management agreement. (Tr. 116). However, no evidence has been presented in this proceeding to justify changing CGC's asset management agreement, much less evidence to justify the need for an independent review. All of the evidence in this docket supports the finding that the customers of CGC have received significant value from the asset management agreements.

As explained in Subsection (A) above, the TRA already has processes in place through the Company's annual ACA, PBR, and IMCR filings to audit and review the transactions that Sequent is performing with CGC's fallow assets to generate the gain returned to CGC's customers. (Tr. 156). The Company provides any additional information or explanations that the Staff may request to perform its regulatory functions. (Tr. 156-157). Also, CGC has included in its asset management agreement a provision for Sequent to submit to an on-site audit of its use of CGC's regulated asset if requested by the TRA. (Tr. 118). There is no need to impose additional rigid processes and timeframes on CGC through a separate costly proceeding. Further, the CAPD has failed to present evidence sufficient to justify changing the sharing mechanism that has resulted in significant value being returned to CGC's customers.

D. The CAPD Has Failed to Meet Its Burden of Proof Regarding the Issue of Affiliate Transaction Guidelines.

The CAPD failed to meet its burden of proof to justify any changes to CGC's existing affiliate transaction guidelines in its Tariff. In fact, the CAPD has failed to provide any evidence of improper affiliate relationships.

In its ACA Audit Docket 04-00402, CGC submitted a revised Tariff that included Affiliate Transaction Guidelines and Standards of Conduct to deter the risk of preferential treatment of an affiliate over a non-affiliate. At the regularly scheduled January 23, 2006 Authority Conference, the TRA approved the revised Tariff submitted by the Company. See April 24, 2006 TRA Order in Docket 04-00402. The Consumer Advocate did not participate or submit comments regarding CGC's Tariff revision or proposed affiliate transaction guidelines.

Mr. Sherwood testified in the current proceeding that the Company has implemented the RFP process and affiliate guidelines so that the TRA and the customers can understand the parameters of the affiliate relationship. (Tr. 185). Sequent has spent \$10 million to implement information systems that allow it to be accountable for the transactions that it performs using CGC's assets and for the gross margins that are generated as a result of the transactions. (Tr. 185-186). CGC has the necessary policies and infrastructure in place to create transparency and thus ensure that the affiliate relationship between CGC and Sequent is proper and benefits CGC's customers. The CAPD has failed to identify any changes to make to CGC's affiliate guidelines.

Based on the lack of evidence presented by the CAPD, the TRA should decline to revise the affiliated guidelines set forth in CGC's Tariff.

E. CGC Should Be Allowed Recovery of Its Litigation Expense.

CGC is seeking to recover its prudently incurred costs associated with defending this docket through the Purchased Gas Adjustment Rule ("PGA"), Chapter 1220-4-7. The CAPD does not object to the customers paying for costs that were prudently incurred to defend this case. (Tr. 15).

The Hearing Officer granted CGC's request to accumulate and defer the litigation costs incurred in defending this docket. (See Order on March 7, 2008 Status Conference (filed March 11, 2008)). The Hearing Officer has ordered CGC to file proof of the accumulated and deferred litigation costs it has incurred after the close of this proceeding.

CGC is confident that the proof will show that the costs it has incurred to defend this case were prudently incurred based on the facts and circumstances of this case. This proceeding was not initiated by CGC. As summarized in Section II above, the CAPD has been litigating issues related to asset management and capacity release since CGC filed its last rate case in June 2006. On January 14, 2008, the TRA convened this contested case proceeding so that the CAPD could litigate its issues regarding gas supply and capacity planning and asset management. The CAPD has the burden of proof on the substantive issues in this docket.

In the spring of 2008, CGC moved for an early dismissal of this case as explained in Section II above. The TRA denied CGC's motion to dismiss.

Throughout the approximately two (2) years of litigation, CGC has responded to over 226 data requests. As explained in Section II above, three of the four rounds of discovery resulted in briefing and status conferences to resolve the CAPD's motions to compel. As evidenced in CGC's filing of an objection and motion to strike the hearsay portions of Dr. Brown's testimony, CGC was forced to take affirmative action to have the

CAPD correct its improperly filed testimony and to afford CGC the opportunity to respond to new issues that were improperly raised by Dr. Brown for the first time in his rebuttal testimony. This improper testimony led to another round of testimony, a fourth round of discovery, and the subsequent withdrawal of the bulk of the CAPD's testimony.

In this case, CGC was placed in the position of defending its actions and the Authority's current approved procedures, and CGC acted prudently in doing so. The CAPD has failed to meet its burden of proof as to any issue in this docket. The CAPD has failed to offer testimony on a majority of the issues that the CAPD raised in this docket. The CAPD has provided no evidence to justify any of the changes or remedies that it is seeking in this docket.

CGC believes that it is proper to allow CGC to recover the prudently incurred costs of this litigation through the PGA. The TRA has traditionally reviewed and handled all costs associated with gas supply and capacity assets, as well as all revenues generated from non-jurisdictional transactions associated with capacity assets, through the PGA. The issues enumerated on the Issues List in this docket and set forth in Section II above relate solely to CGC's gas supply and capacity assets and the management of those assets, including the sharing of gains generated from non-jurisdictional transactions with CGC's customers. Thus, it is proper for CGC to recover the costs associated with the litigation in this contested case proceeding through the PGA.

The TRA has allowed natural gas companies to recover expenses associated with gas and capacity related costs through the PGA. In Rule 1220-4-7-.05, the TRA has recognized the costs incurred by a company to engage an outside consultant to perform a prudency audit of gas and capacity related costs included in its PGA and has allowed the

company to recover those expenses through the PGA. As the litigation costs that CGC has incurred in this matter are related to gas and capacity related costs that are recoverable through its PGA, it is appropriate for CGC to recover these costs through the PGA. CGC is agreeable to recovering these costs over the next three (3) years to dampen the effect on the PGA.

IV. Conclusion

The CAPD has the burden of proof on all substantive issues in this docket. The CAPD has presented no testimony or evidence regarding the gas and capacity supply issues. The CAPD has failed to present evidence to justify the changes and remedies sought regarding CGC's asset management agreement.

The TRA's current review processes and authority are sufficient to provide the appropriate oversight of gas supply and capacity planning and asset management. The CAPD has presented no proof that the TRA's current processes are not working. Additionally, the CAPD has presented no evidence of problems with CGC's gas and capacity supply planning or asset management to justify adopting the rigid review frequency and structure proposed by the CAPD.

While CGC did not initiate this proceeding and does not have the burden of proof, CGC has presented testimony and evidence that would justify the TRA's finding for CGC on all issues. CGC requests that the TRA find that (1) CGC has the appropriate level and mix of capacity supply assets to serve the demands of its customer on the coldest days of the year; (2) CGC's RFP procedures are fair and reasonable and ensure that fair market value is received from the successful bidder; (3) CGC's asset management hybrid compensation arrangement is reasonable and has returned significant

value to CGC's customers; (4) CGC's affiliate transaction guidelines are appropriate and are sufficient; and (5) CGC may recover prudently incurred litigation costs through the PGA. CGC further requests that the TRA enter a Final Order with ordering paragraphs as set forth in the Preliminary Statement above.

Respectfully submitted,

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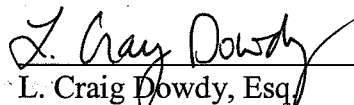
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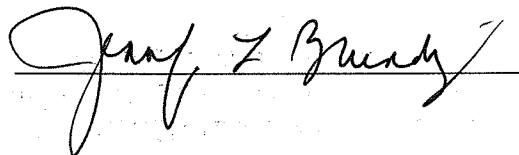
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CERTIFICATE OF SERVICE

I hereby certify that on this 31st day of July 2009, a true and correct copy of the foregoing was served on the persons below by electronic mail:

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A handwritten signature in cursive script, appearing to read "Jeff Z Brandy", is written over a horizontal line.