BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

IN RE:	)	
	)	
PETITION OF CHATTANOOGA GAS	)	
COMPANY FOR APPROVAL OF ITS	)	**DOCKET NO. 09-00183**
RATES AND CHARGES, MODIFICATION	)	
OF ITS RATE DESIGN, AND REVISED	)	
TARIFF	)	

CONSUMER ADVOCATE'S MOTION TO COMPEL

Robert E. Cooper, Jr., the Attorney General and Reporter for the State of Tennessee, through the Consumer Advocate and Protection Division ("Consumer Advocate"), respectfully moves the Tennessee Regulatory Authority ("TRA" or "Authority") to compel Chattanooga Gas Company ("CGC") to fully and completely respond to its discovery requests as set forth below:

INTRODUCTION

The discovery still in dispute involves requests that seek information regarding the potential sale of CGC's "Capacity Demand Assets," as defined below, to its affiliate SouthStar Energy Services ("SouthStar"), either directly or by and through other affiliated companies, which might artificially understate CGC's profits and, thereby, overstate the need for the rate increase proposed in this docket. Specifically, the Consumer Advocate requests the hearing officer compel responsive answers to the following requests: 201 and 202 from the *Discovery Request of the Consumer Advocate to Chattanooga Gas Company*, January 6, 2010. The parties have resolved all other objections to discovery raised by CGC.

STANDARD FOR DISCOVERY

Tennessee has a broad policy which favors the discovery of any relevant information:

> Parties may obtain discovery regarding any matter, not privileged, which is relevant to the subject matter involved in the pending action, whether it relates to the claim or defense of the party seeking discovery or to the claim or defense of any other party, including the existence, description, nature, custody, condition and location of any books, documents, or other tangible things and the identity and location of persons having knowledge of any discoverable matter. It is not ground for objection that the information sought will be inadmissible at the trial if the information sought appears reasonably calculated to lead to the discovery of admissible evidence.

Tenn. R. Civ. P. 26.02(1). Thus, evidence does not have to be admissible to be discoverable as long as the information sought appears reasonably calculated to lead to the discovery of admissible evidence.

Today, it is through discovery rather than pleadings that the parties attempt "to find the truth and to prepare for the disposition of the case in favor of the party who is justly deserving of a judgment." Kuehne & Nagel, Inc. v. Preston, Skahan & Smith International, Inc., 2002 WL 1389615 at *3 (Tenn. Ct. App. 2002) (*quoting* Irving Kaufman, *Judicial Control Over Discovery*, 28 F.R.D. 111, 125 (1962)). Accordingly, a party seeking discovery is entitled to obtain any information that is relevant to the case and not privileged. Id. Consistent with Tennessee's open discovery policy, the relevancy requirement is "**construed broadly to encompass any matter that bears on, or that reasonably could lead to other matters that could bear on any of the case's issues.**" Id. (emphasis added). Discovery, therefore, is not limited to the issues raised by the pleadings. See Id., see also Shipley v. Tennessee Farmers Mutual Ins. Co., 1991 WL 77540 at *7-8 (Tenn. Ct. App. 1991). A party may also use discovery to: define and clarify the issues; probe a variety of fact-oriented issues that are not related to the

merits of the case; formulate and interject additional issues into the case which relate to the subject matter of the pleadings; and determine additional causes of actions or claims which need to be or can be asserted against a party or against third parties. See Shipley, 1991 WL 77540 at *7-8 (*quoting* Vythoulkas v. Vanderbilt University Hospital, 693 S.W.2d 350, 359 (Tenn. Ct. App. 1985)).

It is nonetheless recognized that the trial court may limit discovery under appropriate circumstances. Because of the broad policy favoring discovery, the trial court should not order limitations on discovery unless the party opposing discovery can demonstrate with more than conclusory statements and generalizations that the discovery limitations are necessary to protect the party from annoyance, embarrassment, oppression, or undue burden and expense. See Duncan v. Duncan, 789 S.W.2d 557, 561 (Tenn. Ct. App. 1991). The trial court should decline to limit discovery if the party opposing discovery cannot produce specific facts to support the requested limitations. *See Id.* Moreover, given the liberal construction of discovery rules, the trial court should approach any request for limitations with common sense rather than with narrow legalisms, basing the reasonableness of any ordered limitations on the character of the information sought, the issues involved, and the procedural posture of the case. Id. Rather than denying discovery outright, it is appropriate for the trial court to fashion remedies to discovery issues by balancing the competing interests and hardships of the parties and by considering whether there are less burdensome means for acquiring the requested information. Id.

DISCOVERY REQUESTS IN QUESTION

The Consumer Advocate has filed this Motion to Compel with regard to the following Discovery Requests:

REQUEST NO. 201 Admit or Deny: Capacity Demand Costs of Chattanooga Gas Company are sold directly or indirectly through Sequent Energy Management to SouthStar Energy Services, an AGL Resources subsidiary. For purposes of this and the following interrogatory only, "Capacity Demand Costs" shall be defined as gas commodity costs, interstate pipeline capacity, or any other costs associated with the gas supply plan of Chattanooga Gas Company.

If Denied, please describe what specific portions of the preceding are denied and why they are inaccurate.

REQUEST NO. 202 If the preceding interrogatory is "admitted," how much profit was earned by SouthStar on the capacity demand costs purchased from Chattanooga Gas Company through Sequent Energy Management. Please provide your answer by year from the period of 2003 until the present.

Counsel for CGC objects to the Consumer Advocate's discovery requests No. 201 and No. 202 on the grounds that these requests "seek information that is not relevant to a rate case proceeding," *Chattanooga Gas Company's Objections to CAPD's First Discovery Requests*, p.6 (January 13, 2010). CGC goes on to allege that the Consumer Advocate is "seeking information regarding capacity asset issues that have been litigated for the past two years in Docket 07-00224." Id. However, this is simply not correct.

In these requests, the Consumer Advocate seeks to discover if CGC sold any of its "Capacity Demand Costs," directly or indirectly, to SouthStar, an affiliate of CGC, and, if so, what profit SouthStar may have earned on those transactions during the specified period. Upon information and belief, SouthStar is an affiliate of CGC who has a physical presence in Tennessee and is in the business of selling various natural gas assets which could be included in "Capacity Demand Costs." Obviously, if CGC sells its "Capacity Demand Costs" to SouthStar, who then sells those assets for a profit, those additional profits do not flow back to CGC's ratepayers, and ratepayers are not receiving the benefit of all of CGC's revenues, unless

SouthStar's additional profits are imputed to CGC. See American Association of Retired Persons v. Tennessee Public Service Commission, 896 S.W.2d 127, 134 (Tenn. Ct. App. 1994) (referring to a recognized practice of imputing earnings of BAPCO, the publisher of Yellow Pages, to its parent company, BellSouth). Similarly, if CGC sells its "Capacity Demand Costs" to an intermediary affiliate, such as Sequent, who then sells them to SouthStar, the profits from SouthStar's sales to a third party also should be imputed to CGC. Id.

Therefore, the purpose of these requests is to determine what, if any, of the revenues associated with the sale of "Capacity Demand Costs" by an affiliated corporation should be imputed to CGC and, as a result, reduce the need for the proposed rate increase in Docket 09-00183. For example, assume that Sequent Energy Management ("Sequent"), the asset manager of CGC who has paid for the rights to CGC's natural gas assets, sells gas to SouthStar at a profit per unit of $2; then, SouthStar sells it to someone else at an additional $2 profit per unit. Under the sharing arrangement between Sequent and CGC, ratepayers would get one-half of the $2 profit from the sale to SouthStar, or $1. However, ratepayers get no portion of the subsequent sale by SouthStar. In this hypothetical, it would be the contention of the Consumer Advocate that the gas assets were really worth the additional $2 profit SouthStar received in the subsequent arm's-length transaction on the open-market, or a total of $4 profit, rather than just the $2 profit Sequent received in the affiliated transaction. Therefore, CGC's ratepayers should have gotten $2, half of the total $4 profit, rather than the $1 they actually received. In effect, SouthStar would be a mere conduit to wash out the value that should have gone to consumers. The only way to get this profit back to ratepayers is to look at the dealings between SouthStar and CGC, either directly or by and through Sequent, and then at SouthStar's subsequent sale of those assets.

The most fundamental and basic accounting rules clearly favor the disclosure of affiliate transactions. Under Generally Accepted Accounting Principles ("GAAP"), as promulgated by the Financial Accounting Standards Board:

> **Transactions involving related parties cannot be presumed to be carried out on an arm's length basis**, as the requisite conditions of competitive, free-market dealings may not exist. Representations about transactions with related parties, if made, shall not imply that the related party transactions were consummated on terms equivalent to those that prevail in arm's-length transactions unless such representations can be substantiated...

Statement of Financial Accounting Standards No. 57: Related Party Disclosures, p.5, ¶3 (March 1982) (emphasis added). Furthermore, the Financial Accounting Standards Board ("FASB") explained "**for accounting information to be useful, it should be relevant (meaning that it has predictive or feedback value) and reliable (meaning that it has representational faithfulness, verifiability, and neutrality).**" Id. at 7, ¶12, *citing FASB Concepts Statement No. 2, Qualitative Characteristics of Accounting Information* (emphasis added). FASB goes on to explain that related party transactions specifically do not satisfy the requirements that data be "relevant" and "reliable." Id. at 7-8. With regard to the relevancy of related party data, FASB explains that:

> Accounting information is relevant if it is 'capable of making a difference in a decision by helping users to form predictions about the outcomes of past, present, and future events or to confirm or correct expectations.' **Relationships between parties may enable one of the parties to exercise a degree of influence over the other such that the influenced party may be favored or caused to subordinate its independent interests**....for example, the terms under which a subsidiary leases equipment to another subsidiary of a common parent may be imposed by the common parent and might vary significantly from one lease to another because of circumstances entirely unrelated to market prices for similar leases...

Id. at 7, ¶13 (emphasis added). FASB also explains that the reliability of data in related party transactions is similarly compromised:

> Reliability of financial information involves 'assurance that accounting measures represent what they purport to represent.' Without disclosure to the contrary, there is a general presumption that transactions reflected in financial statements have been consummated on an arm's length basis between independent parties. However that presumption is not justified when related party transactions exist because the requisite conditions of competitive, free-market dealings may not exist. **Because it is possible for related party transactions to be arranged to obtain certain results desired by the related parties, the resulting accounting measures may not represent what they usually would be expected to represent.**

Id. at 8, ¶15 (emphasis added). For all of the reasons espoused by the FASB, related party transactions in financial statements are required to be either eliminated or accompanied by certain disclosures, including the nature of relationships involved, a description of the transactions, the dollar amounts of transactions, and amounts due from or to related parties. Id. at 5, ¶2.

In Docket 09-00183, the Authority is the decision maker who may be affected by the reliability and relevancy of the data provided by CGC in its filing requesting a rate increase. It is the Authority that must determine if CGC has presented the appropriate level of revenues and expenses in those filings. However, any sales of "Capacity Demand Costs" from CGC to its affiliate SouthStar create problems with the relevancy and reliability of that data. It is imperative that the Consumer Advocate receive answers to these discovery requests in order to ensure that all "Capacity Demand Costs" sold by CGC to SouthStar are at full market value (i.e. that they include the profits of all sales by SouthStar of CGC assets), before they are again sold by SouthStar on the open market; if not, SouthStar is improperly recording profits that should be imputed to CGC, thereby artificially inflating CGC's need for an increase in the rates charged to

its customers. It is important to note that the Consumer Advocate is not alleging that any such activity is actually taking place, but, for all of the reasons explained by the FASB above, due diligence requires that the Consumer Advocate investigate this possibility to ensure that ratepayers are not paying higher rates than are proper given the full economic picture of CGC's operations.

In light of the above, the Consumer Advocate has clearly demonstrated that these discovery requests are consistent with Tennessee's open discovery policy, as explained by the Court of Appeal's in Duncan v. Duncan, "The Tennessee Rules of Civil Procedure embody a broad policy favoring the discovery of any relevant, non-privileged evidence," 789 S.W.2d 557, 561 (Tenn. Ct. App. 1991). Furthermore, these requests meet the relevancy requirement, which is "construed broadly to encompass any matter that bears on, or that reasonably could lead to other matters that could bear on any of the case's issues," Kuehne & Nagel, Inc., at 3. However, it should be noted that the Consumer Advocate has no burden of proof in relation to these discovery requests; rather, as ordered by the Court of Appeals in Duncan, "the party opposing discovery must demonstrate with more than conclusory statements and generalizations that the discovery limitations are necessary to protect the party from annoyance, embarrassment, oppression, or undue burden and expense," at 561. Additionally, the Duncan Court held that "a trial court should decline to limit discovery if the party seeking the limitations cannot produce specific facts to support its request." Id. Therefore, it is CGC, not the Consumer Advocate, with the burden of proof in relation to these discovery requests, and, at present, CGC has not satisfied this burden.

CGC's primary argument that these discovery requests are somehow related to the issue of "gas supply and capacity asset issues that have been litigated for the past two years in Docket 07-00224," is without merit, *Chattanooga Gas Company's Objections to CAPD's First Discovery Requests*, p.6. That docket explored the issue of whether the arrangement between CGC and its asset manager, Sequent, was organized in the best interests of CGC's ratepayers. These discovery requests have nothing to do with those issues; in fact, even if you presume that CGC's dealings with Sequent are fully negotiated arm's-length, market transactions, it does not lessen the risk associated with sales of CGC's "Capacity Demand Costs" to SouthStar, or the need to ensure that any such transactions are taking place at full market value. The inclusion of Sequent in these discovery requests is to point out that the sales might take place between CGC and SouthStar by and through Sequent as the representative of CGC, and to ensure that all such sales are fully and properly recorded. The Consumer Advocate has no interest in exploring the issues of Docket 07-00224 further in the present rate case; any future examination of those issues will properly take place during the triennial review ordered by the Authority at the conclusion of Docket 07-00224. However, the Consumer Advocate does assert that it is absolutely necessary to explore any sales of CGC's "Capacity Demand Costs" to SouthStar in order to make certain that CGC's revenues are not artificially understated due to affiliated transactions.

Finally, CGC asserts that these discovery requests are "overly broad and unduly burdensome," *Chattanooga Gas Company's Objections to CAPD's First Discovery Requests*, p.7. That is a difficult notion to accept if one merely analyzes the requests above. Request No. 201 simply asks CGC to admit or deny whether or not any sales of "Capacity Demand Costs" between CGC and SouthStar take place; surely, such information is known or accessible by CGC given that the transactions would take place entirely within and between affiliated companies.

Furthermore, if no such transactions exist, nothing further is required of CGC by these discovery requests; it would be difficult for the Consumer Advocate to craft a less burdensome set of questions in relation to these concerns. Similarly, Request No. 202 is only activated if such sales do take place, creating a legitimate risk of profit understatement in CGC's rate filings, and further scrutiny is needed. Even if an answer to Request No. 202 is required, it merely seeks to learn the amount of profit earned by SouthStar on any such transactions. Even the most basic accounting systems should have this information readily available and easily accessible by CGC and its affiliates.

WHEREFORE, the Consumer Advocate respectfully requests that the Authority enter an order compelling CGC to produce full and complete answers to the Consumer Advocate's discovery requests as outlined above.

Respectfully submitted,

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CERTIFICATE OF SERVICE

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This the 20th day of January, 2010.

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