BEFORE THE
TENNESSEE REGULATORY AUTHORITY

PREPARED DIRECT TESTIMONY
OF
STEVE LINDSEY

IN RE:
CHATTANOOGA GAS COMPANY
DOCKET NO. _________

Q. Please state your name and business address.

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

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

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

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

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

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

A. The purpose of my testimony is to provide a general overview of CGC, to discuss the major challenges that CGC and its customers face in realizing the full benefits associated with energy efficiency and conservation because of the adverse financial incentives inherent in traditional rate designs, and to introduce our request for a rate increase and for a rate design that aligns CGC's and its customers' interests when conservation occurs. I also discuss several of the Company's operational decisions, including the Company's bare steel and cast iron replacement plan and their effect on overall operating expenses and cost of service.

In addition to my testimony, Ronald D. Hanson will provide testimony concerning the Company's expenses, investment in utility property, capital structure, and revenue deficiency of $2.6 million; Marcie Shields will provide testimony concerning the Company's base revenue; Rhonda Watts will introduce proposed depreciation rates based on the Company's depreciation study; Donna Peeples will introduce the Company's proposed energy conservation program called energySMART, including the community outreach and customer education program component; Daniel Nikolich will support the cost benefit analyses of the conservation programs and introduce the Company's proposed recovery mechanism for the program costs and introduce proposed changes to CGC's tariff; Daniel P. Yardley will provide testimony proposing changes in the manner that the Company recovers base distribution revenue requirements based, in part, on the allocated cost of service study and will introduce the Company's proposed revenue decoupling mechanism, the Alignment and Usage Adjustment, that will allow the Company the opportunity to earn a fair and reasonable return while implementing and promoting its proposed conservation programs; and Dr. Roger Morin will address the required capital structure and cost of equity.

I.
GENERAL OVERVIEW OF CGC

Q. Would you please describe the Company?

A. CGC has been serving customers in Tennessee for over 120 years and now serves approximately 61,000 customers in Chattanooga and Cleveland and the surrounding Hamilton and Bradley County areas, including approximately 53,000 residential customers, 8,000 commercial and small industrial customers, and 70 large industrial customers. Though the Company certainly has undergone significant changes over the years, we never have wavered on our commitment to provide safe and reliable natural gas service. The Company is committed to maintaining or enhancing customer service and customer satisfaction through enhanced technology, through our never-ending commitment to operational excellence, and through our promotion of energy efficiency as a means for a customer to reduce gas costs on bills and also to benefit the environment by potentially reducing a customer's carbon footprint. Today, CGC is a wholly-owned subsidiary of AGL Resources Inc. ("AGLR"), an energy-based services holding company. AGLR also is the parent company of utilities operating in five other states along the east coast from Florida to New Jersey.

Q. Why is the Company requesting a rate increase at this time?

A. CGC was last granted a general rate increase of $1,999,097, after factoring in a revenue shift from the Weather Normalization Adjustment ("WNA") to base rates, effective January 1, 2007, in Tennessee Regulatory Authority Docket No. 06-00175. As a provision of the settlement agreement in that rate case, CGC agreed to file a rate case no later than May 28, 2010. CGC is bringing this rate case, in part, to fulfill this obligation as well as to address the $2.6 million revenue deficiency that CGC is experiencing. CGC is also addressing in this rate case the Tennessee Regulatory Authority's ("TRA" or "Authority") request in Docket 09-00065 for CGC to propose a rate design that aligns the customers' and the Company's interests with implementing conservation programs and affording the utility with an opportunity to timely recover costs.

When the TRA approved the $1,999,097 rate increase in Docket No. 06-00175, the new base rates were projected to produce base revenues of approximately $31.9 million. The projected base revenue for the attrition period (ending April 30, 2011) is $30 million, or a decrease of $1.9 million from the Company's previous rate case. While approximately $.5 million of this decrease is due to an update to the Company's 30 year normal weather pattern and will not result in an increase in rates to the customer, the remaining $1.4 million represents real reductions in the Company's base revenues. Although we have worked hard to control costs since the last rate case, these efforts are more than being offset by lost base revenue.

Q. How is CGC planning to alleviate the impact reduced consumption has on its operating margins?

The Company's rates are currently designed to recover a significant portion of its costs, including a just and reasonable return, by a charge per therm. Therefore, when consumption decreases, the Company is not given the same opportunity to recover its costs. Of course, conservation is good for our customers, the state, and the country and should be promoted by energy companies across the country. But therein lies the problem; under traditional rate design mechanisms, the interests of our customers and the interests of CGC are not aligned. Our rate design proposal is designed to alleviate this conflict by both encouraging conservation while at the same time providing CGC an opportunity to earn a just and reasonable return. This proposal will align the interests of the customer and the interests of the Company by encouraging customers to conserve while at the same time allowing CGC to recover its costs and earn its authorized return.

II.
ENERGY CONSERVATION AND RATE DESIGN MODIFICATION

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

A. During the past decade with the huge increases and fluctuations in natural gas prices, CGC and its customers have focused on energy conservation as a means of controlling natural gas prices and customers' monthly utility bills. The actual price of the commodity of natural gas comprises approximately 70% of customers' utility bills as a pass through charge that is recovered from customers through the Actual Cost Adjustment ("ACA"). The other approximately 30% of customers' bills is the cost to CGC of operating the system and delivering the commodity, which is recovered from customers through base rates. The challenge is that conservation limits our ability to earn a just and reasonable return and maintain reliable service under the current rate structure.

Q. Does CGC's existing rate structure provide an incentive for CGC to promote conservation programs?

A. No. The majority of the Company's costs are fixed, but the Company recovers a significant portion of its margins through variable charges which are based on customer volume or usage. The effect of conservation is to reduce customer volume or usage. Maintaining the linkage between the margin recovery and customer usage incentivizes the Company to grow throughput, rather than encourage conservation, so that it can have the opportunity to earn its authorized rate of return.

Q. Do you believe that the Company's interests regarding energy efficiency should be aligned with its customers through its rate design?

A. Yes. Eliminating the throughput incentives is necessary for utilities to be able to fully assist in advancing Tennessee's energy policy agenda. This is why we have evaluated the manner in which the Company currently recovers its base distribution revenue requirements and are proposing changes that are consistent with important national and local energy policy objectives. As explained in more detail in the testimony of Daniel P. Yardley, the Company's proposed rate design modification will fully align the interests of the Company and its customers by removing the throughput incentive inherent in the existing rate structure.

Q. Have regulators and legislators recognized the conflicts that are inherent in traditional rate designs?

A. Yes. The United States has adopted policies to address energy efficiency concerns through passage of the Public Utility Regulatory Policies Act ("PURPA"), which is codified at 15 U.S.C § 3203(b)(5) and (6), and the American Recovery and Reinvestment

Act of 2009 (the "Stimulus Act"). These policies promote programs that encourage energy conservation while also aligning utility incentives so that utilities continue to have the opportunity to earn a fair and reasonable return thus ensuring the continued reliable service of natural gas to the American public.

The PURPA statute sets forth standards for state public utility authorities to consider and either adopt or state in writing the reasons for not doing so. These PURPA standards require natural gas utilities to integrate energy efficiency resources into their planning processes and also require that the rates charged by natural gas utilities align utility incentives with implementation of conservation programs.

The 2009 Stimulus Act requires Tennessee to implement policies regarding energy efficiency or risk jeopardizing the State's ability to receive Energy Efficiency and Renewable Energy Grants. The Stimulus Act requires the TRA to implement a policy that ensures that utility financial incentives are aligned with helping their customers use energy more efficiently and provides an opportunity for utilities to recover costs timely.

On June 25, 2009, Tennessee Governor Phil Bredesen signed into law Senate Bill 2357/House Bill 2389 which became Public Chapter 531 codified at Tenn. Code Ann. § 65-4-126. This Section requires the TRA to implement policy for each natural gas utility to ensure that the utility's financial incentives are aligned with helping its customers use natural gas more efficiently and to provide the utility with an opportunity for timely cost recovery.

To effectuate these important national and local energy policy objectives, the TRA has convened a Docket to Consider the Appropriateness of Implementation of PURPA Standard 5 (Energy Efficiency) and Standard 6 (Rate Design Modification) for Piedmont Natural Gas Company, Chattanooga Gas Company, and Atmos Energy Company (Docket 09-00065) and has instructed the natural gas companies to advise when and how each utility intends to implement the policy of aligning the utility's financial incentives with helping customers use energy more efficiently. As CGC advised the TRA, CGC will implement this policy through the proposed conservation programs and rate design modifications set forth in this rate case.

Q. Mr. Lindsey, does the Company's rate case proposal include programs and policies that allow the Authority to achieve these important national and local energy policy objectives and mandates?

A. Yes. CGC is including in its current rate case proposal its conservation program energySMART and a rate design modification that decouples the Company's opportunity to earn a fair and reasonable return from customer usage. As explained in the testimony of Daniel P. Yardley, the Company's proposal will align the interests of CGC and its customers and is consistent with the energy policy initiatives mandated by the federal government in PURPA and the Stimulus Act and by the Tennessee General Assembly in Tenn. Code Ann. § 65-4-126.

Q. Please describe the Company's proposed rate design modifications.

A. The Company is proposing a two-fold approach to modifying the Company's rate designs by (1) adopting higher fixed charges that are more reflective of the cost of serving customers, and (2) implementing a revenue decoupling mechanism, called Alignment and Usage Adjustment ("AUA"), that will normalize revenues-per-customer to the levels that ultimately will be used to establish base rates in this rate case. Both components of the proposed rate design modification are important and necessary.

Q. Please describe the AUA component.

A. The AUA decoupling mechanism is designed to break the link between customer usage or throughput and CGC's earnings. Simply put, the AUA will normalize total base revenue recovery so that the Company will have the opportunity to earn its authorized rate of return even when actual customer usage varies from the level used to set base rates. By breaking this link, the Authority will be allowing changes to occur in the manner in which conservation and energy efficiency opportunities are made available to CGC's customers. Increased communication and opportunities to conserve will lead to increased customer satisfaction as customers are better able to manage and reduce their utility bills and to reduce their carbon footprint through conservation.

As discussed in the testimony of Daniel P. Yardley, the Company is proposing the AUA in support of its revenue decoupling plan, in part, because it is conceptually consistent with the Company's existing Weather Normalization Adjustment ("WNA"), which has been successfully implemented to address weather-related effects on revenue recovery. The AUA will work much the same way as the WNA but will address more than just weather-related effects on revenue recovery. If the Company's proposed AUA is approved, the Company will discontinue its WNA.

Q. To what customer classes will the AUA apply?

A. The AUA applies to the residential R-1 customer class and to the C-1, C-2 and T-3 commercial classes.

Q. Why are both components of the proposed rate design modification needed?

A. The Company is only proposing a moderate increase in fixed rates. Significant distribution costs are still recovered through usage charges. Therefore, the AUA revenue decoupling mechanism will still be necessary to permit the Company to have the opportunity to earn the authorized rate of return while actively promoting energy conservation and encouraging customers to reduce consumption and realize the associated cost savings.

Q. Please describe the Company's proposed conservation program energySMART.

A. energySMART consists of a consumer education initiative, the Community Outreach and Customer Education Program, and additional energy conservation components for residential and commercial customers. For residential customers, these additional energy conservation components are the Programmable Thermostat Program, the Low-Income Home Weatherization Program, and three programs that focus on encouraging customers to install high-efficiency natural gas water heaters (both tank and tankless) and furnaces. The goal of the Company's proposed programs is to create a philosophical and behavioral change in its customers that is sustainable.

As discussed in Donna Peeples' testimony, if a residential customer takes advantage of the energySMART program, he or she could potentially save up to $280 annually, including savings on electric appliances through the use of programmable thermostats.

Mr. Nikolich and Ms. Peeples provide additional information on the savings impacts of each component of the energySMART program in their testimonies.

Q. Please describe the Low-Income Home Weatherization Program component of energySMART.

A. The Low-Income Home Weatherization component of energySMART targets the needs of our low-income customers through the direct installation of cost-effective energy efficiency measures as determined through home audits. As explained in the testimony of Donna Peeples, CGC will partner with local agencies that administer the Weatherization Assistance Program to Hamilton and Bradley County residents in CGC's service area. CGC is proposing that the costs associated with the Low-Income Home Weatherization Program be funded out of CGC's share of the gains generated by CGC's asset manager in accordance with the Interruptible Margin Credit Rider in CGC's tariff.

Q. Please describe the Community Outreach and Education Program component of energySMART.

A. The Community Outreach and Education Program is a fundamental part of the success of the Company's energySMART program. This component focuses on raising our customers' general awareness of the importance of energy conservation and on educating them about the specific programs that they can participate in to conserve natural gas and lower their energy bills by utilizing the expertise in our marketing and corporate communications departments.

Q. How will the Community Outreach and Education Program component of energySMART be funded?

A. The costs of the Community Outreach and Education Program are estimated to be $300,000 in the first year and gradually decreasing the next two years to a baseline level of approximately $200,000. CGC proposes to fund up to $100,000 of the costs incurred over the baseline amount during the first year, $50,000 over the baseline in the second year, and $25,000 over the baseline in the third year. CGC will not request recovery of these committed amounts.

Q. How does the Company propose to fund the remaining components of energySMART?

A. The Company proposes to fund the remaining components of energySMART through an energy conservation adjustment, the specifics of which will be discussed further in the direct testimony of Daniel Nikolich.

Q. Mr. Lindsey, please explain CGC's commitment and efforts to encourage energy conservation.

A. CGC has recognized these needs and has been a leader in these efforts. This is why, over three (3) years ago as part of our last rate case, CGC proposed a comprehensive rate design that ensured conservation and allowed CGC the opportunity to earn a just and reasonable return. As that rate case settled, CGC's comprehensive rate design proposal was never considered by the Authority in that docket, but CGC has continued to address these issues in other dockets established by the Authority. As I will discuss later in my testimony, CGC has maintained a strong track record for controlling and even reducing costs to operate a safe and reliable system. In fact, CGC's costs have increased less than 1% annually since the last base rate case in 2006. The Company firmly believes that had its proposed comprehensive rate design been implemented in its last rate case, this rate case petition would be more of a compliance filing with a minimal request for rate relief.

CGC is appreciative of the Authority's leadership and efforts to develop policies in Tennessee to promote energy conservation. CGC has consistently advocated for policies and programs that promote conservation while aligning the interests of the utility and its customers. CGC is glad to have participated in the Authority's Home Energy Task Force (Docket 06-00309) and in the Generic Contested Case Docket to Analyze and Evaluate the Cost-Benefit and Funding Mechanism for Energy Conservation Research (Docket 08-00064). The Company's proposed energySMART conservation program along with the rate design modification set forth in this rate case accomplishes the goals requested by the TRA in Docket 09-00065 of promoting energy efficiency programs and aligning the utility's financial incentives with helping customers use energy more efficiently and is consistent with the public policy set forth by the Tennessee General Assembly.

III.
OPERATING DECISIONS AND THE RESULTING IMPACTS ON CGC'S COST OF SERVICE

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

A. CGC has been successful in managing its costs, in part, by taking advantage of the opportunities available to it by being part of the AGLR system. Although I am ultimately responsible for the day-to-day operations of CGC, I make every effort to take advantage of these benefits available to CGC in order to provide real benefits to CGC's customers. As a subsidiary of AGLR, CGC has the opportunity to draw on the experience gained by its affiliated LDCs and to refine practices that have proved beneficial to customers in other service areas. Likewise, CGC jointly participates in, and reaps the benefits of, shared programs that result in service improvements that could not be undertaken if CGC were not affiliated with AGLR. In addition, AGLR's industry standing and its ability to provide competitive compensation and career opportunities enable CGC to benefit from outstanding talent in all aspects of its operations. Significantly, AGL Services Company (AGSC) experts provide assistance to CGC in all facets of its operations. CGC could not afford to employ such experts as a stand-alone company.

Though bigger is not necessarily better, we clearly believe the operational synergies, implementation of "best practices," and the market presence of AGLR all are positive factors in minimizing costs to, and providing a safe and reliable system for our customers. Clearly, CGC's customers also benefit from CGC's relationship with AGLR. For CGC's fiscal year ended September 30, 2000, just prior to AGLR's acquisition of Virginia Natural Gas ("VNG"), CGC's operations and maintenance expense, including AGSC shared service allocations, was $15.9 million. As Company witness Hanson will describe in more detail, the operations and maintenance expense included in the cost of service in this case is $12.0 million, a *decrease* of almost $4 million, most of which can be attributed to the synergies and cost savings achieved through AGLR's acquisition of VNG in 2000 and NUI Corporation in 2004, as well as AGLR's substantial investments in technology and implementation of industry "best practices" during the past ten years. Such decreases in costs directly impact the costs to CGC's customers.

By way of comparison, inflation has risen 19% over the same time period. Put simply, if CGC were operating as part of a much smaller AGLR similar to 2000, its operations and maintenance expenses could be $3 million higher than its 2000 operations and maintenance expense – a $7 million difference from what CGC is estimating its operations and maintenance expense in this case. Additionally, while inflation has risen 19% since 2000, the Company's base rates have increased a modest 6%, including CGC's proposed base rate increase in this case.

I believe that we have been very successful in managing costs within our control. Although we constantly are seeking out value, we have picked much of the "low hanging fruit" in the areas that impact the distribution portion of the customer's bill and finding more value on that front will prove to be more and more challenging. As Company witness Ronald Hanson will describe in more detail, total operating expenses are expected to decrease by $1.1 million. This is due in large part to the proposed decrease in depreciation expenses of $1.3 million.

Q. Please describe the decrease in depreciation expenses and its effect on overall operating expenses.

A. As part of the settlement in the last rate case, CGC agreed to propose the adoption of the Average Life Group ("ALG") depreciation for rate making purposes. As explained in the testimony of Rhonda Watts, we are submitting a depreciation study proposing the adoption of ALG depreciation rates. The calculations used to support this rate case proposal are based on using the ALG depreciation rates. The effect of the adoption of ALG depreciation rates is to decrease the depreciation expenses, thus resulting in a decrease in the cost of service. The adoption of the ALG depreciation rates prevented the revenue deficiency from being approximately $1.3 million greater than the amount that the Company is seeking in this rate case.

Q. Please describe decisions made by the Company to enhance and increase customer satisfaction and the impact of these decisions on the Company's overall operating expenses included in this rate case.

A. CGC has installed a remote meter reading system throughout its jurisdictional territory which allows it to receive automated meter readings in-house. Automated meter reading ensures more accurate readings and thus more accurate customer billing. This has resulted in a reduction of operation and maintenance expense of approximately $266,000.

Q. Please describe your decision to transition the customer service call center functions back to the United States.

A. With the upcoming expiration of the current contract with WIPRO, CGC's customer service calls will be handled internally by AGSC employees at the existing call center in Georgia. The decision to outsource the customer service call center functions in 2006/2007 was made to improve quality and to reduce costs. While WIPRO's contractual obligations were met, our customer's expectations were not met in that they wished to speak to someone in the United State when doing business with us. With the WIPRO contract coming up for renewal, it afforded us the opportunity to take a fresh look at how we manage our customer calls. Customer care and customer satisfaction are a core part of our business and are very important for the success of our business. Therefore, we are responding to our customers' desires and are relocating the customer care center services for CGC to Riverdale, Georgia. At the same time, given the current state of the U.S. economy, we believe that now is the right time to invest in our country and to help create American jobs.

Q. Mr. Lindsey, please explain the Company's bare steel and cast iron replacement plan.

A. As the Company emphasized in its last rate case, CGC is committed to the integrity, safety and reliability of its distribution system. In keeping with this commitment, CGC has developed a ten year plan to replace approximately 59 miles of bare steel and cast iron pipe that remain in its distribution system today.

While in the last rate case CGC proposed a bare steel and cast iron replacement program recovery tracker which was not part of the settlement agreement, CGC is not proposing such a tracker in this case. The settlement agreement did, however, include a commitment by CGC to replace almost 21 miles of bare steel and cast iron pipe through December 31, 2010, which the company is currently on schedule to accomplish. The Company's ten year replacement plan is scheduled to begin in 2010 and continue through 2019 and is in addition to the 21 miles CGC already committed to replace in its last rate case. Once completed, CGC will have replaced approximately 80 miles of bare steel and cast iron pipe over a thirteen year period.

Q. Mr. Lindsey, how will the Company recover the costs of the bare steel and cast iron replacement program absent a cost recovery tracker?

Unlike other construction projects that extend the system and add new customers, this main replacement activity will not produce additional base revenue. Thus, the program will cause the rate base to increase resulting in an increase in the return requirements, the related taxes, and the deprecation expense without any offsetting base revenue. CGC will only be afforded the opportunity to fully recover its costs and earn a reasonable return on these investments that will take place over the next ten years through future rate cases. While such an aggressive and substantial investment program could require frequent rate cases, I am optimistic that implementation of our proposed AUA will alleviate the pressure of CGC's continued decline in customer margins and, coupled with our proven track record of controlling costs, frequent rate case proceedings may not be necessary.

Q. While CGC has been able to lower operating expenses, why is CGC experiencing the approximately $2.6 million revenue deficiency?

A. As discussed previously in my testimony, the primary factor in the Company's revenue deficiency is a substantial decrease in margins compared to the last rate case. The Company has also experienced a decrease in rate base due to a substantial decrease in its stored gas inventory, and CGC is also proposing a higher cost of capital to allow it to earn a fair and reasonable return on its investments. As I have previously discussed, the need for a rate increase could have been alleviated by the implementation of a rate design plan similar to the Company's proposed AUA.

Q. Please explain how the Company has assisted the community in bringing new industry growth to the Chattanooga area.

A. CGC has worked with the State and the mayors of the City of Chattanooga and of Hamilton County to assist in providing Volkswagen Group of America Chattanooga Operations, LLC ("Volkswagen") with the services needed to operate its future plant in Chattanooga, Tennessee. The Special Gas Extension Contract between CGC and Volkswagen was approved by the Authority on October 26, 2009. In addition, CGC is proposing an Economic Development Tariff in this case as described further by Mr. Nikolich. CGC anticipates Volkswagen will take advantage of this new tariff.

CGC is happy to be part of the community's efforts to bring Volkswagen to the Chattanooga community and the State of Tennessee. Volkswagen is a leader in environmentally friendly policies and will bring jobs and revenues to the Chattanooga economy, thus benefitting the local community and the entire State.

Q. Do you have any final comments?

A. Yes. We have worked hard to achieve benefits for CGC's customers, and we have been able to do so by focusing on both short-and long-term issues and solutions. Our proposed energySMART conservation program along with our proposed rate design modification will provide both CGC and the TRA an opportunity to be leaders in the effort to promote energy conservation. The AUA revenue decoupling mechanism will align the interests of the Company and the interests of its customers and will allow the Company the opportunity to earn a fair and reasonable return when conservation and reduced customer usage occur because of the Company's successful energySMART conservation program. This will lead to increased customer satisfaction as customers are able to realize savings on their monthly bills and to achieve environmental benefits through the potential reduction in their carbon footprint. I respectfully urge the Authority to consider the long-term benefits that energySMART and CGC's rate design modification proposal, including the AUA, will bring to both our customers and the State of Tennessee.

Q. Does this conclude your testimony?

A. Yes.