BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

May 7, 2010

IN RE:	)	
	)	
PETITION OF CHATTANOOGA GAS	)	
FOR GENERAL RATE INCREASE,	)	Docket No. 09-00183
IMPLEMENTATION OF THE	)	
ENERGYSMART CONSERVATION	)	
PROGRAMS, AND IMPLEMENTATION OF	)	
A REVENUE DECOUPLING MECHANISM	)	
	)	

CHATTANOOGA GAS COMPANY'S POST-HEARING BRIEF

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CHATTANOOGA GAS COMPANY'S POST-HEARING BRIEF

Pursuant to Chairman Kyle's directions at the hearing on the merits in this matter, Chattanooga Gas Company ("CGC" or "Company") respectfully submits this brief in support of its petition for a rate increase and implementation of the energySMART conservation program along with the implementation of its proposed rate design that will fully align the Company's and the ratepayer's interests.

EXECUTIVE SUMMARY

The Company's energySMART Conservation Program and the Alignment of Interests

The time for removing the financial disincentives for a local distribution company to aggressively promote energy conservation is now. CGC has presented the energySMART conservation program which is cost effective, measurable and verifiable, and through the community outreach and customer education component will help achieve behavioral changes that are sustainable and not merely driven by increases in the price of natural gas. Along with its conservation program, the Company has proposed an Alignment and Usage Adjustment (AUA") mechanism that will fully align the interests of the Company and its ratepayers by removing the disincentives inherent in current volumetric rate designs. Additionally, in response to the Tennessee Regulatory Authority ("TRA" or "Authority") Staff's data requests, the Company has proposed two alternative forms of straight fixed variable rate designs that the Company also believes will fully align interests. The details of the energySMART program and the alignment of interest component are set forth in Section I. herein.

Revenue Requirement

The Company has requested a rate increase to allow the Company to earn an additional $2.6 million in revenues. As a result of updates due to utilizing more current data for a proposed test period ending December 31, 2009, the Company has reduced its request to $2.2 million as discussed in Company witness Ronald Hanson's rebuttal testimony and exhibits. The Consumer Advocate and Protection Division ("CAPD" or "Consumer Advocate") of the Office of the Attorney General is proposing a rate decrease of approximately $200,000 after allowing for the additional $111,000 in depreciation expense as explained in Section III.D. The primary differences in the revenue requirement between the CAPD and CGC are the cost of capital which results in a difference in revenue requirement of $1.5 million and the proposed elimination of certain operating expenses by the CAPD totaling approximately $1 million.

Of the $2.2 million in revenue deficiency, $1.9 million is required for CGC to achieve the level of revenue approved by the TRA in CGC's last rate case (Docket 06-00175). In that docket, the TRA approved rates that would produce approximately $31.9 million annually in base revenue. However, the projected base revenue for the attrition period ending April 30, 2011 is approximately $30 million or $1.9 million less than the level approved three years ago by the TRA. The remaining $300,000 is a result of cost differences from the 2006 rate case.

Cost of Capital

The Company is proposing a fair and reasonable rate of return on common equity capital ("ROE") of 10.75% if the Company's proposed alignment of interests is adopted and 11% if rejected. Section II. provides a detailed explanation of Dr. Morin's analysis and justifications for the Company's proposed ROE as well as points out the flaws in Dr. Klein's analysis and recommendation. The Company has proposed a capital structure for ratemaking purposes that reflects a known and reasonable level of short term debt while the CAPD's proposed capital structure is based on a backward looking analysis.

Operating Expense Disagreements

The CAPD and CGC have fundamental differences about how the TRA should treat several operating expenses which are normal operating costs of a regulated utility. Regarding the revenue requirements, CGC has agreed to many of the demands of the Consumer Advocate. However, as set forth in Sections III.A.-C. herein, CGC has compromised as much as it can and firmly believes that it should be allowed to recover the following remaining issues:

1. *Variable Compensation* -- CGC has included only market level compensation, including both fixed and variable components, and therefore is entitled to include an additional amount over the CAPD's recommendation of $210,592 for the AIP and $189,359 for the LTIP as set forth in Exhibit RDH-5, Schedule 5 and Exhibit RDH-8 of Ronald Hanson's pre-filed rebuttal testimony.

2. *Rate Case Costs*-- All of the projected rate case costs were prudently incurred to bring this case and therefore CGC should be allowed to recover the cost of

$210,667, which is a $104,131 increase over the CAPD's recommendation as set forth in Revised Ronald Hanson Workpaper 4 attached hereto.

3. *Forecast of Legal Costs for the Attrition Period* -- The amount of $590,821, which is a $396,208 increase over the CAPD's recommendation (as set forth in Exhibit RDH-5, Schedule 5 and Exhibit RDH-8 of Ronald Hanson's pre-filed rebuttal testimony) is an accurate forecast of the legal expenses for the attrition period given the overly litigious environment in Tennessee as testified to by Mr. Archie Hickerson.

During the hearing on the merits, the parties were able to reach agreement about the appropriate level of depreciation expense, which included an additional $111,480 conditioned upon the TRA's ordering the Company to allocate accumulated depreciation reserves consistent with the Company's depreciation study, as set forth in Exhibit RDH-5, Schedule 1 and Exhibit RDH-8 of Ronald Hanson's pre-filed rebuttal testimony. This agreement results in a total depreciation expense of $5,312,911.00 for the attrition period as set forth more fully in Section III.D. herein.

CGC also requests, as set forth in Section III.E., that the TRA not adopt the CAPD's "consumer protection" recommendations at this time because the Company's current practices and procedures are working well and the CAPD has not provided any contrary evidence.

Recovery of Litigation Costs From Docket 07-00224

For approximately two (2) years, CGC had to defend itself as the respondent against the outrageous and totally unsupported accusations brought against it by the CAPD in Docket 07-0224. CGC is requesting to recover over three (3) years through the PGA the approximately

$745,000 in litigation costs that it prudently incurred. Section IV. herein sets forth the arguments in support of this recovery.

I. THE COMPANY'S energySMART CONSERVATION PROGRAM AND THE ALIGNMENT OF INTERESTS

Senator Andy Berke from Chattanooga best summarized one of the principle issues in this docket when he addressed the TRA at the hearing on the merits:

> ...I believe that conservation is a worthy goal of our government. When avenues are available to encourage conservation of natural gas, we should examine them closely.
>
> The rate structure portion of this case presents this issue squarely before you. Currently to return the maximum amount to its shareholders, the utility has every incentive to deliver more and more product to customers. We need to change that to ensure that it is instead able to engage in environmentally-sensitive techniques without harming its shareholders.
>
> I encourage you today to fully align the interests of the utility with conservation. Whether doing so is through decoupling, a straight-fixed variable, or some other design is beyond my knowledge. What I do know, however, is that there is a way to align these interests better, and you have the ability to find it.[1]

The country and the State of Tennessee have engaged in an open and honest debate on how to accomplish the full alignment of the interests of the customers and the shareholders of utilities. The United States Department of Energy and the United States Environmental Protection Agency formed a powerful, influential and balanced stakeholders' group[2] that developed a National Action Plan for Energy Efficiency[3] that clearly and unequivocally called for creativity and a non-traditional approach for the development of rate designs to accomplish the goals of conservation.[4] Governor Bredesen, in his letter dated March 23, 2009 to the

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[1] Senator Andy Berke, Vol. I, Tr. 118:23 – 119:16.
[2] Yardley, Pre-filed Direct Testimony, Exhibit DPY-2, pgs. 12-13.
[3] Yardley, Pre-filed Direct Testimony, Exhibit DPY-2.
[4] Yardley, Pre-filed Direct Testimony, Exhibit DPY-2, pgs. 17-19.

Secretary of the Department of Energy, and through the Administration's technical corrections bill, Public Chapter 531 (2009), codified at Tenn. Code Ann. § 65-4-126, called for state action on this important national and state policy. Likewise, both the Stimulus Act and Public Utility Regulatory Policies Act ("PURPA") encourage this alignment of interests.

CGC has presented to the Authority a comprehensive and multifaceted conservation program, called energySMART, which consists of measurable and verifiable programs along with a rate design that includes an alignment and usage adjustment ("AUA") mechanism to accomplish the goal of removing the financial disincentives for a utility to aggressively promote the reduced usage of natural gas by its customers. The Company's AUA mechanism will fully align the interests of the Company and its customers. In response to TRA Staff data request number 29, CGC has also proposed two forms of straight fixed variable rate designs that it believes are appropriate alternatives to the AUA mechanism and will also align the interests of the Company and its customers and remove the financial disincentives for CGC to promote conservation. CGC's energySMART program and its plan for alignment of interests have all the components necessary for approval by this Authority. CGC has brought this plan as part of a rate case to ensure that the alignment of interests is implemented on the basis of accurate and up-to-date base revenues and associated billing determinants. CGC believes that the implementation of the energySMART programs along with one of its three proposed rate design modifications, including the AUA, will accomplish the goals set forth in Tenn. Code Ann. §65-4-126.

The CAPD relies upon the testimony of Dr. David Dismukes to present its position on the Company's rate alignment proposals. Dr. Dismukes offered extensive pre-filed testimony, which the Company strongly disagrees with. In assessing the appropriateness of Dr. Dismukes' recommendations, it is critical to understand the fundamental viewpoint that he is espousing. Dr. Dismukes testified extensively that in his opinion the Company's existing rate design already aligns the interests of customers and the Company.[5] Thus, Dr. Dismukes concludes that no action on the part of the TRA is necessary in this proceeding in order to achieve the alignment of interests called for in Tenn. Code Ann. §65-4-126. In essence, the CAPD argues through Witness Dismukes that the legislature's call for the TRA to implement a general policy "that ensures that utility financial incentives are aligned with helping their customers use energy more efficiently and that provides timely cost recovery and a timely earnings opportunity for utilities associated with cost-effective measurable and verifiable efficiency savings" requires absolutely no change to rate design.

This viewpoint and philosophy are squarely at odds with the policy framework established by the legislature in Tenn. Code Ann. §65-4-126 and with mainstream thought and direction regarding delivering additional benefits of energy efficiency to customers. The stark contrast between Senator Berke's equivocal testimony calling for a change in rate design and the underlying philosophy of the CAPD is plain to see. In laying the foundation for its proposals, the Company itself explained the extensive work by many entities representing all facets of the industry to address the fundamental challenges facing consumers and the environment associated with increasing energy consumption. On repeated occasions, the National Association of Regulatory Utility Commissioners ("NARUC") implored member commissions to consider innovative rate designs to promote energy efficiency.[6] In addition, the Company already noted the work of the National Action Plan for Energy Efficiency, which is represented by an extensive

[5] Dismukes, Vol. II, Tr. 439:2-11.
[6] Yardley, Pre-filed Direct Testimony, at 12:11-27.

stakeholder group working together to broaden the benefits of energy efficiency.[7] The stakeholders leading this effort are provided in Mr. Yardley's Direct Testimony at Exhibit DPY-2, pages 12 and 13. Under cross-examination, Dr. Dismukes repeatedly dismissed the relevance of the National Action Plan recommendations because he claimed that there were no consumer representatives involved.[8] Clearly, Dr. Dismukes has no interest in allowing changes to the Company's rate structure that would align the interests of the Company and its customers as have been implemented in many other jurisdictions and are receiving great attention and focus from NARUC and a broad array of industry stakeholders, as well as the American Council for an Energy Efficient Economy ("ACEEE") and the Natural Resources Defense Council ("NRDC").[9]

The viewpoint and underlying philosophy of Dr. Dismukes permeates all of his recommendations. Since his viewpoint and philosophy are squarely at odds with the intent of the legislature's policy here in Tennessee and with the leading proponents of energy efficiency throughout the United States, the Company strongly urges the TRA to dismiss the relevancy of his recommendations to CGC. The Company is not addressing the specific recommendations here; however, Mr. Yardley has detailed the concerns with these recommendations in his rebuttal testimony.[10]

Dr. Dismukes characterizes a number of his recommendations as "customer protections". While this terminology is attractive, it is not representative of the true intent, which is clearly to prevent rate alignment by restricting the effect of the rate design changes that are implemented. Most of Dr. Dismukes claimed protections have not been crafted based upon Chattanooga Gas-

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[7] Yardley, Pre-filed Direct Testimony, at 10:13 – 12:10. One member of the stakeholder group is Mary Healey, Consumer Counsel for the State of Connecticut and current President of NASUCA. *See* Dismukes, Vol. II, Tr. 519:18 – 520:13.

[8] *See, e.g.,* Dismukes, Vol. II, Tr. 450:10 – 452:1.

[9] Dismukes, Vol. II, Tr. 461:1 - 464:1-4; Yardley, Pre-filed Direct Testimony, at 9-10 & Exhibit DPY-1.

[10] Yardley, Pre-filed Rebuttal Testimony, at 2-29.

specific facts, but are borrowed from other jurisdictions where rate design innovation has been adopted through negotiated settlements that were in proceedings independent of a base rate case.[11] These factors alone make it difficult to transfer the mechanisms to CGC. More importantly, the Company's rate design proposals reduce the revenue risks for customers associated with change in consumption and ensure that customers pay on average the base revenues authorized by the TRA in a base rate case proceeding. This is an intrinsic consumer protection in and of itself when compared with traditional rate design. Unfortunately, the "protections" offered by Dr. Dismukes are harmful to customers in that they reestablish the direct link between utility earnings and customer throughput. Had Dr. Dismukes recommended any mechanisms that offered true protections to consumers, the Company would have embraced them.[12]

CGC has a vested interest in maximizing the benefits of the natural gas service that customers receive from the Company. The rate design innovation and increased emphasis on energy efficiency that result have been demonstrated to increase customer satisfaction. Customers desire to reduce their energy consumption in order to manage their utility bills and lower their emissions of greenhouse gases.[13] CGC strongly urges the TRA to reject the rate alignment recommendations of the CAPD, which would maintain the existing impediments to realizing the benefits for consumers.

[11] Yardley, Pre-filed Rebuttal Testimony, at 26:13-18.
[12] In the event that the TRA is concerned about the potential impact of the rate design changes that are needed to promote energy efficiency, the Company noted a potential safeguard that could be introduced. Specifically, the TRA could require a full rate case filing in the event that revenue deferrals under the AUA proposal reach a level equal to 10% of revenues. *See* Yardley, Pre-filed Rebuttal Testimony, at 28:4-16.
[13] Yardley, Pre-filed Direct Testimony, at 15:21 – 16:10.

A. The Company's Proposed energySMART Conservation Programs

As explained by Company witness Donna Peeples, the Vice President of Corporate Communications and Chief Marketing Officer of AGL Resources Inc. ("AGL"), the Company's proposed energySMART program is designed to drive a philosophical and behavioral change in its customers that is sustainable and not merely driven by increases in the price of natural gas.[14] Most customers want to do the right thing when it comes to energy and the environment, but they are not sure what that is.[15] CGC wants to provide the necessary resources to help their customers solve these challenges.

The energySMART program targets various customers and market segments based on need, point of decision opportunities, and general education and will save residential and commercial customers money by reducing usage and thereby utility bills as well as conserving natural resources and minimizing environmental impact.[16] The energySMART program consists of five components for residential customers:[17] (1) a free programmable thermostat program; (2) a low income weatherization grant program; (3) an incentive program for tankless water heaters; (4) an incentive program for high efficiency furnaces; and (5) an incentive program for high efficiency water heaters. If a residential customer takes advantage of these programs, the customer could save up to $280 annually.[18] The energySMART program also consists of five programs for commercial customers that are outlined in the testimony of Donna Peebles and Dan

[14] Peeples, Pre-filed Direct Testimony, at 5.
[15] *Id.*
[16] Peeples, Pre-filed Direct Testimony, at 3:1-6.
[17] For specific details of each residential program, see Peeples, Pre-filed Direct Testimony, at 12-14, and for the cost benefit analysis of each program, see Nikolich, Pre-filed Direct Testimony, at 4-16.
[18] Peeples, Pre-filed Direct Testimony, at 10.

Nikolich.[19] If a commercial customer takes advantage of these programs, the customer could save up to $500 annually.[20]

An important component of the energySMART program is the Community Outreach and Customer Education Program which will be specifically tailored to CGC's customers. Company witness Donna Peeples passionately and convincingly testified that, if approved by the TRA, she would develop and oversee a Chattanooga-specific education and community outreach program utilizing programs developed and successfully implemented in other jurisdictions served by AGL.[21] Ms. Peeples explained that the program would be designed not as a mass marketing campaign for the utility, but rather as an educational campaign targeted at the Company's current customers to promote energy efficiency.[22] In her pre-filed direct testimony on pages 6-10, Ms. Peeples explains how the Community Outreach and Customer Education Program will be specifically designed for CGC's customers. Having the Vice President of Corporate Communications and Chief Marketing Officer testify for the first time in this case demonstrates the corporate commitment at the highest levels to the success of the energySMART conservation program.

CGC is committing to fund up to $100,000 of the costs incurred above the baseline level of $200,000 for the Community Outreach and Customer Education Program for the first year, up to $50,000 over the baseline in the second year, and up to $25,000 over the baseline in the third year.[23] CGC is not requesting recovery of these committed amounts.[24]

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[19] Peeples, Pre-filed Direct Testimony, at 16; Nikolich, Pre-filed Direct Testimony, at 12-15 & Exhibit DJN-1.
[20] Peeples, Pre-filed Direct Testimony, at 11.
[21] Peeples, Pre-filed Direct Testimony, at 6-10.
[22] Peeples, Pre-filed Rebuttal Testimony, at 2.
[23] Lindsey, Pre-filed Direct Testimony, at 12.
[24] Lindsey, Vol. I, Tr. 49:6-7.

As explained in the testimony of company witness Dan Nikolich, CGC is proposing to recover the actual costs of the energySMART programs through a separate monthly per therm charge to the residential and commercial customers.[25] The costs will be projected for a 12 month period, and any over recovery from the prior year will be subtracted from the 12 month budgeted amount and any under recovery from the prior year will be added.

Ms. Peeples refutes the proposition that customers are going to pay more for using less natural gas if rate alignment is adopted. Since 70% of the customer's bill consists of the commodity cost of natural gas, a customer's reduction in their total bill will likely be significant.[26] In addition, Mr. Yardley explained that the operation of the proposed AUA results in customers paying no more and no less than the average base revenue per customer authorized by the TRA in a base rate proceeding.[27]

1. <u>The energySMART Program is Cost Effective, Measurable and Verifiable</u>.

Through the testimony of Company witness Dan Nikolich, CGC has demonstrated with clear and convincing evidence that its proposed energySMART conservation program is cost effective and measurable and verifiable. The extensive cost benefits analysis performed by Mr. Nikolich was virtually unchallenged on cross examination by the intervenors. Mr. Nikolich's detailed analysis utilized all known and widely accepted tests[28] and was supported by recent data from the Chattanooga pilot programs.[29] In total, all of this supports Mr. Nikolich's conclusion that CGC's proposed energySMART program is cost effective, measurable, and verifiable.[30] Thus, the standards set forth in Tenn. Code Ann. § 65-4-126 are met.

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[25] Nikolich, Pre-filed Direct Testimony, at 16-17.
[26] Yardley, Vol. I, Tr. 260:14-18; Peeples, Vol. I, Tr. 95:3-9; Nikolich, Vol. I, Tr. 116:17-117:1.
[27] Yardley, Vol. I, Tr. 260:1 – 260:18
[28] Nikolich, Vol. I, Tr. 99:8 – 100:18; Nikolich, Pre-filed Direct Testimony, at 3-4.
[29] Nikolich, Vol. I, Tr. 99:3-7.
[30] Nikolich, Vol. I, Tr. 101:23-102:8.

In applying the five traditional tests,[31] Mr. Nikolich determined the cost benefit analysis of each of the energySMART programs.[32] The details of the tests performed by Mr. Nikolich are set forth in his pre-filed direct testimony on pages 5-15, and the results are summarized on pages 15-16 and on Exhibits DJN-1 and DJN-2. Mr. Nikolich has testified and has concluded that in total the energySMART program is cost effective and should be approved.[33] Based upon these analyses, the Company's proposed conservation measures will decrease the customer's weather normalized consumption, the average customer's total gas bill, and promote saving energy in a cost-effective manner.

The only witness who provides testimony contrary to CGC's extensive pre-filed testimony and pre-filed exhibits and proof is Dr. David Dismukes. However, Dr. Dismukes' testimony was simply discredited. A significant portion of Dr. Dismukes' testimony is based on a 2004-2005 California study rather than on Chattanooga specific data.[34] CGC contends that this California study provided stale numbers from a state with very little similarities to Chattanooga, Tennessee, and was performed during a period of time when the California housing boom was underway. Other differences between California and Chattanooga have been pointed out both in cross-examination as well as in rebuttal testimony.[35]

In contrast, Dan Nikolich based a portion of his analysis upon actual usage data for Chattanooga customers pre and post implementation of similar energy efficiency measures that was obtained from Chattanooga specific pilot conservation programs from 2006 to 2008.[36] On cross-examination, Dr. Dismukes denied having considered the pre and post usage data from the

[31] Nikolich, Vol. I, Tr. 99:8 – 100:18; Nikolich, Pre-filed Direct Testimony, at 3-4.
[32] Nikolich, Pre-filed Direct Testimony & Exhibits DJN-1 and DJN-2.
[33] Nikolich, Vol. I, Tr. 101:23 – 102:8; Nikolich, Pre-filed Direct Testimony, at 16:5-9.
[34] Dismukes, Vol. II, Tr. 479:19 – 481:14.
[35] *See, e.g.,* Nikolich, Pre-filed Rebuttal Testimony, at 10-12.
[36] The Chattanooga pilot programs operated from 2006 to 2009; however, the actual data was generated from 2006 to 2008. Nikolich, Vol. I, Tr. 99:3-7.

Chattanooga specific pilot programs that was provided to the CAPD in response to Discovery Request No. 173. CGC can find no explanation for why Dr. Dismukes decided to base his analysis on the inapplicable data from disparate states rather than utilize data for Chattanooga-specific customers. Dr. Dismukes admits that it is rare to find a ratepayer specific basis of pre and post usage to evaluate conservation programs, but that use of ratepayer-specific data is advisable when available.[37] Therefore, it is incomprehensible why he performed no analysis using the Chattanooga specific pre and post usage data obtained from the Chattanooga specific pilot conservation program.

After Dr. Dismukes' mistake in failing to utilize actual Chattanooga specific data, CGC chose to end the cross examination of Dr. Dismukes rather than to prolong the proceeding by lengthy cross examination. However, the testimony filed in this case clearly shows additional errors in Dr. Dismukes' testimony and analysis. Dr. Dismukes was clearly wrong regarding projected participation rates for the energySMART programs. In Dr. Dismukes' pre-filed testimony, he claims that the participation rates in the Virginia Natural Gas ("VNG") conservation programs are low and thus lead to lower projected participation rates for a Chattanooga specific conservation program than those projected by Company witness Dan Nikolich. However, as pointed out in the rebuttal testimony of Mr. Nikolich and accompanying exhibit DJN-4, Dr. Dismukes understates the participation rates for Chattanooga by 50% in most cases because he bases them upon only 6 months of VNG data.[38] Another glaring difference in Dr. Dismukes' and Mr. Nikolich's cost benefit analysis is Dr. Dismukes' elimination of an

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[37] Dismukes, Vol. II, Tr. 481:9-19.

[38] Nikolich, Pre-filed Rebuttal Testimony, at 6:14-7:12 & Exhibit DJN-4 & DJN-5.

inflation adjustment to escalate capacity costs over time by applying a 0% inflation rate versus the modest 2.5% inflation rate for capacity costs as projected by Mr. Nikolich.[39]

CGC refers the Authority to the detailed rebuttal testimony and exhibits of Dan Nikolich for other areas of dispute in the competing analyses of Dr. Dismukes and Mr. Nikolich, and CGC notes that the CAPD offered very little cross examination of Mr. Nikolich's analysis and opinions. In conclusion, CGC contends that the proof preponderates in favor of CGC and that the Company's proposed energySMART program is cost effective, measurable and verifiable.

As actual conditions and results may differ from the projections, CGC has agreed to identify an independent monitor to perform annual monitoring and verification of the programs. CGC will first approach the University of Tennessee at Chattanooga ("UTC") to determine if UTC has the expertise necessary to provide this independent monitoring. CGC also has agreed in its testimony to form a community advisory panel that will advise and provide input into the implementation of the energySMART programs and offer guidance for future adjustments to the programs if needed.

B. The Company's Proposed Rate Designs That Fully Align Interests

Chattanooga Gas has presented a fair and equitable rate design that aligns the economic interests of the Company with its customers.[40] CGC's proposed changes are necessary to reflect important public policy objectives in Tennessee and the country. CGC's existing rate design recovers a substantial portion of the costs of providing service to customers through variable (or volumetric) delivery charges. This type of rate design provides a disincentive for the Company to promote energy efficiency and conservation and makes it difficult for the Company to have a reasonable opportunity to recover the approved revenue requirements while promoting energy

[39] Nikolich, Pre-filed Rebuttal Testimony, at 7:13 – 8:4 & Exhibit DJN-6.
[40] Yardley, Vol. I, Tr. 258:20-25; 310:16-311:4.

conservation.[41] CGC believes that its existing rate design is no longer appropriate because it fails to align the interests of CGC and its customers by providing a disincentive to CGC to promote energy efficiency and conservation.

The reason for the disincentive that is inherent in traditional rate designs is that a majority of the Company's costs are fixed, but the Company recovers a significant portion of its margins through volumetric charges. This means that, although the Company's costs to operate a safe and reliable distribution system are the same regardless of the volume of gas delivered through the distribution system, the Company will recover less of its costs when less energy is consumed. Maintaining the linkage between base revenue recovery and customer usage incentivizes the Company to encourage increased usage rather than reduced usage so that the Company will have the opportunity to earn its authorized rate of return.

Through the testimony of its expert Daniel P. Yardley, CGC is proposing a new rate design that includes the Alignment and Usage Adjustment ("AUA") tariff which is a base revenue adjustment mechanism that operates in conjunction with the Company's base rates to normalize base revenue recoveries per customer to the level authorized by the TRA in this base rate case. The AUA tariff operates symmetrically to offset variances in usage that occur following a rate case by creating credits or charges. When base revenue recoveries per customer are higher than the authorized level, a credit is applied to customer bills in a future period. Conversely, when base revenues per customer are lower than the authorized level, a charge is applied to customers in a future period. Under the AUA tariff, customers will pay no more and no less to CGC for the distribution services they receive than the base revenue per customer authorized by the TRA in this rate case.[42] Customers will experience substantial bill savings

[41] Yardley, Vol. I, Tr. 259:10-18.
[42] Yardley, Vol. I, Tr. 260:5-18.

when they reduce their consumption through reduction in PGA gas costs which comprises approximately 70% of their bills.

Along with the AUA mechanism, CGC is proposing to increase the customer charge to residential customers. The customer charge provides an important price signal to customers with respect to the costs of receiving distribution service regardless of the level of natural gas consumed each month. The proposed increases to the customer charges promote fairness and reduce intra-class subsidies through the recovery of a greater proportion of fixed costs through a fixed charge.[43]

In response to data requests from the TRA Staff, CGC has carefully developed compromises to its original proposed rate design and has offered two alternative straight fixed variable rate designs that CGC agrees offer a full alignment of interests and are in compliance with the intent of the America Recovery and Reinvestment Act, PURPA, state policy, and the opinion offered by Senator Andy Berke. CGC's expert witness Daniel P. Yardley proposes the first straight fixed variable rate design alternative which is characterized as a demand charge straight fixed variable rate design ("SFV-1") and is set forth in Exhibit DPY-17, page 20 of 23, to his pre-filed rebuttal testimony. The first straight fixed variable alternative replaces the existing delivery (or volumetric) charge in CGC's current rate design with a demand charge applied to customer specific billing demand quantities which reflects the quantity of natural gas utilized at peak period and recognizes size differences among customers. The proposed demand charge is $11.094 per peak unit per month. The demand charge will be adjusted annually to adjust for individual customer's actual usage.[44] The Company is proposing to increase the existing residential customer charge by $1 to yield $13 per month during the winter months and

[43] Yardley, Pre-filed Rebuttal Testimony at 30:11-20 and Yardley, Vol. I, Tr. 284:14-24.
[44] Yardley, Vol. I, Tr. 298:7 – 300:6; 305:20-306:25

$12 per month during the summer months. This represents a smaller increase to the customer charge than under the Company's proposed rate design under the non straight-fixed variable alternative. The lower customer charge accounts for the fact that some fixed costs are recovered through a demand charge.[45]

Mr. Yardley proposes a second straight fixed variable rate design which is characterized as a modified demand charge straight fixed variable rate design ("modified SFV-2") and is set forth in Exhibit DPY-17, page 20 of 23, to his pre-filed rebuttal testimony. The second modified straight fixed variable alternative retains a small delivery (or volumetric) charge to recover a portion of the Company's revenue requirements. There is a demand charge of $7.75 per month. The residential customer charge is increased by $1 as described above under the first straight fixed variable alternative.

The continuation of a delivery charge in the modified straight fixed variable rate design would necessitate retaining the existing weather normalization adjustment albeit at a significantly reduced level due to the lower variable charges.[46] For detailed information on the specific rate design for the R-1 Residential Class as well as information on the other classes[47], please see Exhibit DPY-17 to Daniel P. Yardley's pre-filed rebuttal testimony. Under both of these straight fixed variable alternatives, Mr. Yardley recommends that the programs be "sculpted"[48] so that the bills will be lower in the summer and higher in the winter in order to better match customers' expectations.[49]

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[45] Chattanooga Gas Company Response to Staff Discovery Request Number 29.

[46] Yardley, Pre-filed Rebuttal Testimony, at 31:2-4; Yardley, Vol. I, Tr. 287:23 – 288:8.

[47] Incorporated in the rate designs proposed by Mr. Yardley are increases that result in a slightly greater increase in the residential as compared to the industrial classes pursuant to Mr. Yardley's class cost of service study.

[48] Yardley, Pre-filed Rebuttal Testimony, at 30:3-7; *see also* Yardley, Vol. I, Tr. 287:10-22; Vol. I, Tr. 295:21 – 297:24.

[49] *Id.*

The CAPD claims that either of the straight fixed variable rate design alternatives proposed by the Company weaken the incentive of consumers to conserve by removing the volumetric charge. However, this claim is misguided and fails to account for the specific components of the Company's rate proposals. Under both of the Company's straight fixed variable rate design alternatives, customers experience bill reductions when implementing energy efficiency and conservation. The bill reductions occur because the Company has proposed to reestablish the demand billing determinant each year and will still be dependent upon a customer's actual usage. In addition, customers that reduce their consumption will continue to experience gas supply savings, which account for approximately 70% of a customer's bill. Therefore, it is Mr. Yardley's opinion that his proposed rate designs will not reduce the incentive for individual customers to conserve.[50]

Finally, Mr. Yardley explains in his rebuttal testimony on pages 16-18 why the modified SFV-2 rate design does not shift risks from the utility to the customers. Under a usage-based rate design, both the utility and its customers are exposed to revenue-related risks. Rate alignment that is accomplished through either the implementation of the AUA or through one of the proposed straight fixed variable rate designs reduces the revenue-related risks of both customers and the Company. Because the existing revenue risks are in the opposite direction, revenue risks are not shifted to customers. Mr. Yardley also explains that it is contrary to accepted rate design principles for a rate design to impose significant revenue-related recovery risks.[51]

This modified SFV-2 rate design with the proposed sculpting does not create rate shock and will minimize the impact on low volume ratepayers.[52] Rate shock is eliminated by virtue of the continuation of a size-based charge. While the existing delivery charge is substantially

[50] Yardley, Vol. I, Tr. 275:17-21.
[51] Yardley, Pre-filed Rebuttal Testimony at 16-18.
[52] Yardley, Vol. I, Tr. 283:9 – 284:24; Yardley, Vol., Tr. 278:13-22.

reduced, it is replaced with a demand charge that is applied to customers based upon their size. The result is that individual customer bills do not vary significantly with the implementation of the rate design change. This contrasts with a different form of straight-fixed variable rate design that relies upon an equal flat charge to customers, which could produce significant rate shock for smaller customers. This alternative was rejected by the Company and the potential outcome of this type of rate design should not be confused with the Company's proposal.[53]As stated earlier, CGC believes that any of these proposed rate designs (AUA, SFV-1, or modified SFV-2)[54] will accomplish the goal of full alignment of interests of the customers and ratepayers. CGC also believes that the proposals of the intervening parties,[55] or any increases in the volumetric component of the modified SFV-2 would not remove the financial disincentive of current rate designs, thus not fully aligning the interests of customers and ratepayers, and would not allow the aggressive promotion of conservation that is needed to meet the goal of reduced usage.

It is apparent that all of the CAPD's concerns with straight fixed variable rate design are directed toward a form of straight fixed variable rate design that has been implemented elsewhere; namely, applying the same flat monthly charge to all customers in a specific rate class. CGC's proposals are distinct and are not subject to these same concerns. When the specific facts of the Company's straight fixed variable rate design alternatives are considered, it is evident that the proposals are a reasonable alternative that achieves the alignment of interests between the Company and its customers.

In conclusion, CGC has presented a compelling case that any of the three rate designs recommended by Mr. Yardley will achieve the rate design goals of energy efficiency, revenue

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[53] Yardley, Vol. I, Tr. 278:5 – 279:2 and 291:6-13.

[54] AGL has 12 years of extensive experience in implementing a modified SFV-2 rate design with an affiliate of CGC. *See* Yardley, Pre-filed Rebuttal Testimony, at 31.

[55] CGC believes that the proposals such as the New Jersey Model or the Washington Model are not full alignment and are merely window dressing. *See* Yardley, Vol. I, Tr. 311:11-18 & 262:3-7.

stability, fairness, rate moderation, and simplicity. Furthermore, these three rate designs will be consistent with the attributes of a sound rate structure as described in Mr. Yardley's rebuttal testimony on pages 8 and 9. Adopting one of these three rate designs and fully aligning the interests of CGC's customers and shareholders will allow for the aggressive implementation of its energySMART conservation program which is cost effective, measurable and verifiable.

Chattanooga Gas is proud of its proposal for the promotion of conservation and the alignment of interests presented in this docket. CGC contends that its program as compared to the one presented in Docket 09-00104 provides for an energySMART conservation program that will make the Authority proud and will accomplish conservation and reduced gas bills for its customers. The plan is measurable and verifiable[56] and is supported by a strong corporate commitment. The plan will be implemented simultaneously with the utilization of current revenue forecasts authorized by the TRA in this rate case rather than stale data as was presented in Docket 09-00104.

The energySMART conservation program along with a new rate design that fully aligns customers' and shareholders' interests will result in decreased energy usage, thus reducing energy bills[57] and will allow CGC's customers the opportunity to become more satisfied customers as indicated in the 2008 J.D. Power Customer Satisfaction Study showing higher customer satisfaction with local distribution companies ("LDCs") that have revenue decoupling programs.[58]

Therefore, CGC should be allowed to move forward expeditiously with implementing its energy conservation program on September 1, 2010. CGC should be allowed to implement

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[56] In Docket 09-00104, only two tests were performed by Piedmont Natural Gas Company to establish a cost benefit analysis as compared to the five tests performed by CGC. *See* Nikolich, Vol. I, Tr. 116:11-14.
[57] Peeples, Vol. I, Tr. 92:15 – 93:7.
[58] Yardley, Pre-filed Direct Testimony, at 15-16 & Exhibit DPY-5.

immediately one of the three (3) proposed new rate designs - the AUA tariff, the SFV-1, or the modified SFV-2.

II. COST OF CAPITAL

One of the primary differences between CGC and the CAPD on revenue requirement is the cost of capital which results in a $1.5 million difference. Of this amount, $300,000 reflects the difference in capital structure. As explained in Section II.A. below, the Company has proposed a reasonable capital structure that accounts for known and measurable changes in the Company's costs of short term debt levels. The Company has also proposed a fair and reasonable rate of return on common equity capital as explained in detail in Section II.B. below.

A. The Company has proposed a reasonable capital structure that reflects a known and measurable level of short-term debt.

The Company proposes to utilize for ratemaking purposes a capital structure consisting of 42.15% long-term debt, 6.94% short-term debt, and 50.90% equity.[59] CAPD witness Dr. Christopher Klein proposes a capital structure consisting of 10.0% short term debt, 42.0% long term debt and 48.0% equity.[60] The difference between the Company and the CAPD on capital structure is the differing percentage of short term debt in the total capital structure.[61] As discussed more fully below, the Company's proposed capital structure is known and measurable, while Dr. Klein's capital structure is based on the unreasonable premise that the future will mirror the past.

The Company's proposed capital structure reflects the issuance of $300 million in senior notes by AGL Resources Inc. ("AGL") in August 2009, the proceeds of which were used to

[59] Hanson Pre-filed Direct Testimony, Exhibit RDH-4.
[60] Klein Pre-filed Direct Testimony, Exhibit 1.
[61] Klein, Vol. III, Tr. 770:10-21.

repay short-term debt.[62] Thus, the Company's current capital structure is known and measurable. The Company's proposed capital structure is also generally consistent with the capital structures of the comparable gas distribution companies that are used by Dr. Morin to estimate the cost of equity,[63] and is therefore a reasonable capital structure to be used for ratemaking purposes. In contrast, Dr. Klein has based his proposed 10% short term debt level on the four point average of the percentage of short term debt in the AGL capital structure at June 30, 2007, 2008 and 2009, respectively and the Company's proposed short term debt forecast for the attrition period.[64] However, the record shows that there are a number of reasons why the levels of short-term debt reflected on the Company's balance sheet during the 2007-2009 period are unlikely to re-occur in the period in which the rates established in this proceeding will be in effect.

First, during the historical period, the Company experienced significantly higher gas costs than are forecast to occur during the attrition period.[65] A portion of AGL's need to borrow on a short-term basis is driven by the need to finance gas purchases on a seasonal basis.[66] To the extent that gas prices are forecast to remain below those experienced in the three years ending June 30, 2009,[67] it is unlikely that AGL's short-term debt levels will return to historic levels.

Second, as Dr. Klein agreed, the world financial crisis occurred during the 2008-2009 timeframe.[68] During this period even investment grade companies like AGL would have found it extremely difficult to access the long term debt markets. However, conditions have now improved and AGL was in fact able to issue $300 million of long-term debt in August 2009.

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[62] Hanson, Pre-filed Rebuttal Testimony, at 22.
[63] *Id.* at 23.
[64] *Id.* at 22; Klein, Pre-filed Direct Testimony, Exhibit 2.
[65] Klein, Vol. III, Tr. 795:2-7.
[66] Klein, Vol. III, Tr. 794:15-19; *see also* AGL's 2009 10-K, at 47, 50.
[67] Dr. Klein had no reason to believe that gas costs were likely to return to the high levels experienced during the historical period. Klein, Vol. III, Tr. 795:2-7.
[68] Klein, Vol. III, Tr. 795:8-15.

Assuming that capital markets continue to stabilize, it is more likely than not that AGL's short-term debt levels will not return to the levels experienced in 2007-2009.

In sum, other than a backward looking analysis, Dr. Klein's proposed capital structure is unsupported. However, there are sound reasons to believe that the future will not mimic the past. CGC's proposed capital structure is more reasonable in that it accounts for the known and measurable changes in the Company's short term debt levels that are likely to remain in effect during the attrition period.

B. Return on Equity – The Company's Proposal

Through the testimony of Dr. Roger Morin – a nationally recognized expert on utility cost of capital – the Company is proposing a fair and reasonable rate of return on the common equity capital of 10.75% if the Company's proposed rate alignment is adopted and 11.00% if the proposed rate alignment is rejected. As discussed by Dr. Morin, the proposed ROE (1) is fair to consumers, meaning that there is no transfer of wealth between investors and customers; (2) is commensurate with returns offered on investments of comparable risk; (3) would allow the Company to attract capital; and (4) would preserve the financial integrity of the Company.[69]

1. The Company's ROE Proposal is Supported by Substantial Record Evidence and Appropriately Accounts for the Circumstances of CGC.

Dr. Morin utilized three market-based methodologies to estimate the return required by investors on the common equity capital committed to CGC – the Capital Asset Pricing Methodology ("CAPM"), the Discounted Cash Flow ("DCF") methodology and the Risk Premium Methodology. He applied his DCF methodology to two samples of companies.[70] One proxy group consisted of investment grade natural gas local distribution companies. Because of

[69] Morin, Vol. III, Tr. 692:17 – 693:12.
[70] Dr. Morin also utilized data from his tax proxy groups to calculate the beta used in his CAPM analyses. *See* Morin, Pre-filed Direct Testimony, Exhibit RAM-2.

the small size of that sample, Dr. Morin also used as a second proxy group, a sample that included combination gas and electric utilities in order to have a more statistically valid estimate. Companies with less that 50% of their revenues from regulated operations were eliminated from the second proxy group.[71] The record shows that combination companies are reasonable proxies for natural gas distribution utilities in that they have capital intensive distribution networks and are engaged in the distribution of energy services in cyclical and weather sensitive markets just like natural gas distribution utilities.[72] The combination companies are also highly regulated and subject to rate of return regulation.[73] Furthermore, their allowed rates of return as established by regulatory bodies are virtually identical to natural gas distribution utilities which is evidence of their risk comparability.[74]

The results of all of Dr. Morin's market-based estimates of CGC's ROE include an adjustment for flotation costs.[75] Flotation costs are incurred when new equity is issued. Because they are not expensed, they must be recovered by means of an adjustment to the rate of return.

Flotation costs have both a direct and an indirect component. The direct component is the compensation to the securities underwriter and the operating expenses associated with a new issue.[76] The indirect component represents the downward pressure on the stock price as a result of a new issue.[77] Dr. Morin estimates that total flotation costs – the direct and indirect components – require a 5% adjustment to the dividend yield component of the DCF

[71] Morin, Pre-filed Direct Testimony, at 40.
[72] *Id.* at 39.
[73] *Id.*
[74] *Id.*
[75] *Id.* at 14.
[76] *Id.* at 42-43.
[77] *Id.* at 43.

methodology and corresponding adjustments to the CAPM and risk premium approaches to appropriately compensate investors.[78]

a. Capital Asset Pricing Model

The CAPM attempts to quantify the additional return or risk premium required by equity investors for bearing risks in excess of that required on an equivalent "risk-free" investment.[79] The CAPM assumes that equity investors require a rate of return that is at least equal to the risk-free rate plus appropriate compensation for the risk to which their equity investment is exposed.[80] According to the CAPM, securities are priced such that their expected return equals the risk free rate plus a risk premium. Denoting the risk free rate by R_f and the return on equity securities as a whole as R_m, the formula for the CAPM is:

$$ROE = R_p + B\ (R_m - R_f)$$

Where B or "Beta" measures the change in a security's return relative to changes in the overall market.[81]

Dr. Morin used the current yield on 30-year United States ("U.S.") Treasury bonds as the proxy for the risk-free rate.[82] The rationale for using 30-year Treasuries as a proxy for the risk free rate is that common stock is a long term investment.[83] Actual yields on 30-year Treasury bonds will more closely incorporate within their yields the inflation expectations that influence prices of common stocks than short-term or intermediate term U.S. Treasury notes.[84] Dr. Morin did not utilize short-term rates as reflected in U.S. Treasury bills because they are volatile and

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[78] *Id.* at Appendix B.
[79] *Id.* at 18.
[80] Morin, Vol. III, Tr. 693:21 – 694:2.
[81] *See* Morin, Pre-filed Direct Testimony, at 18, 21. A stock with a beta of less than 1 is less risky than the market as a whole and a stock with a beta of greater than 1 is more risky.
[82] *Id.* at 19.
[83] *Id.*
[84] *Id.* at 20.

are used as policy vehicles to stimulate the economy.[85] The yield on 30-year Treasury bonds prevailing in September 2009 as reported by Value Line and the Federal Reserve was 4.3%, and Dr. Morin used that level in his CAPM calculations.[86] Dr. Morin also utilized a beta of 0.70 and a market risk premium of 7.0%.

Dr. Morin also performed an empirical CAPM ("E-CAPM") that takes into account the empirical finding that CAPM-based estimates of cost of capital tend to underestimate the return required from low-beta securities and overstate the return required from high-beta securities.[87] Because of current unsettled market circumstances, CAPM estimates are not significantly above the cost of new debt capital and thus likely underestimate the cost of equity.[88] As a consequence, Dr. Morin determined that less weight should be given to the CAPM analysis under present circumstances for two reasons. First, the impact of the financial crisis is not fully reflected in the betas employed in the CAPM analysis because the betas are estimated over five-year historical periods.[89] Second, government interest rates have decreased substantially, thus lowering the CAPM results.[90]

b. <u>Historical Risk Premium</u>

The historical risk premium technique looks at the history of utility stocks and compares the difference between the actual realized rate of return on equity capital for the Standard and Poor's Utility Index to government bond returns.[91] Dr. Morin expressed concern about using the historical risk premium given the current state of capital markets. Given that trends in utility cost of capital are reflected in their cost of debt and are not directly captured by a risk premium

[85] *Id.*
[86] *Id.* at 21. The current yield on 30-year Treasury bonds is 4.66% as of April 23, 2010.
[87] *Id.*
[88] *Id.* at 29.
[89] *Id.*
[90] *Id.* at 28-29.
[91] *Id.*

estimate tied to government bond yields, Dr. Morin also performed the historical risk premium analysis using utility bond yields instead of government bond yields.[92]

c. **<u>Discounted Cash Flow</u>**

The discounted cash flow ("DCF") model determines the cost of equity by measuring the current dividend yield plus projected increases in future dividend payments expected by investors.[93] The DCF formula posits that an investor's expected return is the sum of an expected dividend yield plus the expected growth rate of future dividends and stock price.[94] Dr. Morin used analysts' earnings growth forecasts prepared by Zacks Investment Research, Inc. and Value Line as proxies for the expected growth rate in the DCF model.[95]

d. **<u>Dr. Morin's Summary of Analyses</u>**

The results of the various analyses conducted by Dr. Morin range from a low of 9.5% to a high of 11.6% with a midpoint of 10.5%.[96] The average result from all of the tests is also 10.5% as well as the truncated average.[97] The results of the tests performed by Dr. Morin are set forth in a table on page 45 of Dr. Morin's pre-filed direct testimony. In Dr. Morin's opinion, a conservative estimate for the common cost of capital would be 10.5%. As explained further below, Dr. Morin adjusted this conservative estimate by 50 basis points to account for CGC's being riskier than the comparable companies because of its relatively small size (25 basis points) and declining demand and conservation (25 basis points).[98] Thus, Dr. Morin recommends an ROE of 11% for CGC's natural gas utility operations in Tennessee.[99] If the AUA mechanism is

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[92] *Id.* at 31-32.
[93] *Id.* at 33.
[94] *Id.* at 34.
[95] *Id.* at 36.
[96] *Id.* at 45.
[97] *Id.*
[98] *Id.* at 46.
[99] *Id.* at 48.

adopted, Dr. Morin recommends a 10.75% return on equity to reflect the impact of the AUA on the risks of CGC's operations.

2. The Return on Equity Established in this Proceeding Should Reflect the Costs and Risks of CGC, Not AGL.

As discussed *supra*, in estimating the appropriate ROE to be used for ratemaking purposes in this proceeding, Dr. Morin utilized available financial information from publicly traded gas distribution companies and combination gas and electric companies in his DCF and CAPM calculations. In addition, in order to more accurately capture the cost of equity for CGC, Dr. Morin adjusted his recommendation upwards by 50 basis points to account for the fact that CGC's small size and declining demand increase the cost of equity that would be required by investors in CGC's equity above the ROE that would be required by investors in larger, less risky entities such as AGL or the companies in Dr. Morin's two proxy groups.[100]

Dr. Klein disagreed with this approach. Based primarily on the fact that AGL approaches the financing of its various operations from a consolidated perspective,[101] Dr. Klein recommended that the TRA look only to the cost of equity of the parent enterprise – AGL. Dr. Klein asserts that this approach captures "AGL's size and current decoupling status, including that of CGC."[102]

Dr. Klein's approach is fatally flawed for legal, policy and factual reasons. First, from a legal perspective, Dr. Klein's recommendation violates the fundamental tenet of utility regulation that states that a public utility is entitled to rates that will permit it to earn a return "equal to that generally being made at the same time and in the same general part of the country

[100] *Id.* at 46-47.
[101] While Dr. Klein testified that AGL is the only entity that issues external debt of stock [*see* Klein, Pre-filed Direct Testimony, at 9, L. 12-19], this is not correct. Various entities in the AGL organization issue debt to investors. Klein, Vol. III, Tr. 799:10-800:1. By proceeding in this manner, AGL has been able to achieve a very reasonable embedded cost of long term debt of 6.03% that is being used for ratemaking purposes in this proceeding.
[102] Klein, Pre-filed Direct Testimony, at 17 L. 6-7.

on investments in other business undertakings which are attended by corresponding risks and uncertainties."[103] In this proceeding, the TRA has the responsibility to set just and reasonable rates for CGC, not AGL. Therefore, the ROE approved in this proceeding must compensate investors in CGC for the risks attendant to an investment in CGC. The purpose of this proceeding is not to determine the rates needed to compensate AGL's investors for an investment in AGL.

While it might be the case that determining the cost of equity for CGC on the basis of AGL's costs and risks would be appropriate if the entities were comparable, the record shows that this is not the case. There are several differences between AGL and CGC that create material differences between the entities and require the use of the approach supported by Dr. Morin to estimate CGC's cost of equity. These differences include the following:

1. *AGL is a diversified natural gas company, while CGC's operations are limited to the local distribution of gas in Tennessee.* In addition to CGC, AGL owns local distribution companies in five other states. Moreover, AGL has significant investments in a retail provider of natural gas commodity service, a natural gas wholesale trader, liquefied natural gas import facilities, natural gas storage facilities and a provider of communications services.[104] Each of these investments has different costs and risks that collectively create AGL's overall cost and risks. However, there is no basis in the record to conclude that AGL's costs and risks are identical to CGC's costs and risks.

2. *AGL has a market capitalization of roughly $2.7 billion dollars while CGC, standing alone, would be a small company that would command a significant risk premium.* Both Dr. Morin and Dr. Klein recognized that small companies standing alone require a

[103] *See Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679, 692 (1923); *see also Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).
[104] *See* AGL's 2009 Annual Report, at 16.

significant risk premium as compared to larger companies.[105] By using AGL as the basis of his return recommendation without adjusting for CGC's size and risk, Dr. Klein unreasonably fails to recognize and give effect to this empirically observed result, and recommends an ROE that is far too low.

3. *CGC's risks are increased by its declining customer demand, while AGL's gas distribution operations are substantially decoupled.* Even if it is assumed that AGL is considered to be in the same line of business as CGC – local gas distribution – the record shows that CGC's gas distribution operations face a far greater risk than AGL's total gas distribution operations from declining customer demand between rate proceedings. CGC is not decoupled and is thus fully at risk for the loss of revenue from declining customer demand. AGL, on the other hand, has implemented forms of revenue decoupling in Georgia and Virginia that effectively eliminate the risks of declining demand from approximately 1.8 million of AGL's customers.[106] Both Dr. Morin and Dr. Klein recognize that implementing revenue decoupling reduces a local distribution company's risks and corresponding cost of equity to some degree.[107] Thus, to the extent that AGL's data and data from other proxy companies that have implemented revenue decoupling are used to determine CGC's ROE, an increase in the ROE is warranted to recognize CGC's decoupling status. Dr. Morin properly made this adjustment;[108] Dr. Klein did not.

[105] Morin, Pre-filed Rebuttal Testimony, at 23, L. 13-24, L.7; Klein, Vol. III, Tr. 805:19-24, 806:18-807:11, 808:2-10.
[106] Yardley, Pre-filed Direct Testimony, Exhibit DPY-4; Klein, Vol. III, Tr. 813:6-21.
[107] Klein, Vol. III, Tr. 774:8-21.
[108] In addition, during cross-examination, the CAPD's questions appeared to challenge Dr. Morin for constructing a "fictitious" company. It is always necessary to construct something of a "fictitious" enterprise in order to estimate the cost of equity because the cost of equity cannot be observed directly. The challenge is to create a "fictitious" entity that mirrors the costs and risks of the entity under consideration. Dr. Morin has met that challenge, Dr. Klein has not.

While Dr. Klein asserted that AGL's centralized financial management provides a justification for concluding that CGC's ROE was equal to AGL's ROE, Dr. Klein offered no meaningful reason why this result would be fair or reasonable. Dr. Klein did not dispute that CGC was a legally distinct subsidiary of AGL that maintained separate books and records and could be sold to a third party or spun off to AGL's shareholders as an independent entity.[109] In addition, Dr. Klein did not dispute that CGC's relationship to AGL likely provided CGC's customers with benefits such as a lower embedded cost of debt than what would have been available to CGC's customers if CGC were an independent entity.[110]

During cross-examination, Dr. Klein was asked whether he would recommend that CGC's ROE be determined on a stand-alone basis if AGL were to spin CGC off to AGL's shareholders. He replied that in that case, a CGC-specific ROE would be appropriate.[111] In effect, Dr. Klein is suggesting that AGL's ultimate shareholders will obtain a better rate of return if AGL spins off its investment in CGC even though such a spin-off would likely result in higher overall costs to CGC and its customers.[112] This makes no sense. Rather than penalizing AGL and its shareholders for bringing centralized management and efficiencies to CGC and its customers by establishing an ROE that does not reflect CGC's true risks and costs, the TRA should send potential investors in Tennessee utility facilities the policy signal that investors in such facilities will be afforded the opportunity to earn a ROE that reflects the risks and cost of their investments in facilities in Tennessee. The TRA can send this appropriate policy signal clearly and directly by finding that CGC's ROE in this case will be established on the basis of an

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109 Klein, Vol. III, Tr. 800:10-19.
110 Klein, Vol. III, Tr. 801:13 – 802:10 and 805:19-24.
111 Klein, Vol. III, Tr. 804:24 – 805:18.
112 Klein, Vol. III, Tr. 805:19-24.

analysis of CGC's costs and risks as determined by Dr. Morin, and not on the basis of an analysis of AGL's costs and risks as proposed by Dr. Klein.

In addition, leaving aside issues of fundamental fairness, the fact of the matter is that there is no basis in financial theory or the record to conclude that the cost of equity of an investment in CGC's gas distribution operations changes because it is owned by AGL, by Berkshire Hathaway,[113] by a private hedge fund or investor, or by the current shareholders of AGL. As Dr. Morin explained:

> The identity of shareholders is immaterial in determining the equity return. The equity return reflects the risk to which equity capital is exposed and the opportunity return foregone by the Company's shareholders in investments of similar risk.[114]

For all these reasons, the TRA should reject Dr. Klein's recommendation that CGC's cost of equity be established by reference to AGL's market data. Dr. Morin's CGC-specific adjustments are appropriate and should be adopted.

3. The Consumer Advocate's Position on ROE is Too Low to be Credible.

Dr. Klein's recommended 9.5% ROE lies outside of the mainstream of currently allowed rates of return for Dr. Klein's comparable companies and outside the mainstream of currently authorized returns for natural gas utilities across the country. As reported by Regulatory Research Associates, the average allowed ROEs for gas utilities in the years 2008 and 2009 were 10.3% and 10.2%, respectively.[115] The national averages of 10.3% and 10.2% exceed Dr. Klein's 9.5% recommendation by a significant margin. Moreover, Dr. Klein's recommended result would be particularly unreasonable considering that CGC is relatively riskier than the

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[113] Berkshire Hathaway is a holding company chaired by Warren Buffett that owns a diversified portfolio of companies including energy distribution companies. Presumably, under Dr. Klein's view, if AGL sold CGC to Berkshire Hathaway, then CGC's cost of equity would change from AGL's cost of equity to Berkshire Hathaway's cost of equity. This makes no sense.
[114] Morin, Pre-filed Rebuttal Testimony, at 21-22.
[115] *Id.* at 3, 5.

average natural gas utility due to its small size and declining demand.[116] Simply stated, if Dr. Klein's ROE recommendation is adopted, CGC will have one of the lowest, if not the lowest, ROEs for a natural gas distribution utility in the country.[117]

Additionally, the average of the allowed ROEs for the seven (7) natural gas utilities that are owned by or included in Dr. Klein's sample group as of March 2010 is approximately 10.5%.[118] These facts are significant for several reasons. First, all of these comparable companies are far larger than CGC on a stand alone basis. As Dr. Klein acknowledged, smaller companies require a larger risk premium than larger entities.[119] There is no reason why CGC would not command a larger risk premium and a correspondingly higher ROE than the members of Dr. Klein's comparable group.

Second, with the exception of Southwest Gas Company, all of the Companies reflected in Dr. Klein's comparable group have implemented revenue decoupling to one extent or another.[120] Since all parties agree that revenue decoupling reduces risk to some extent, one would expect that CGC would have a greater cost of equity than entities that have implemented revenue decoupling. Certainly, it is inconceivable that CGC, a small company faced with the risk of declining customer demand, would have an ROE that is approximately 100 basis points lower than the average of much larger, decoupled gas distribution companies.

Indeed, even if the TRA were to adopt Dr. Klein's recommendation that CGC's ROE be determined as if it were AGL, establishing an ROE for AGL/CGC that is approximately 100 basis points less than the average ROE approved for Dr. Klein's comparable group is objectively unreasonable. As Dr. Klein indicated on cross examination, the primary indication of the

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[116] *Id.*
[117] *Id.* at 2.
[118] *Id.* at 5- 6 & Table 1.
[119] Klein, Vol. III, Tr. 806:18-807:11.
[120] Yardley, Pre-filed Direct Testimony, Exhibit DPY-4; Klein, Vol. III, Tr. 815.

relative risk of AGL as compared to the other companies in Dr. Klein's sample group is the beta statistics of those companies.[121] Since AGL's beta is 0.75 and those of all other companies in the sample group, other than Southwest Gas Company, are 0.65 or lower,[122] one would expect that AGL's cost of equity would be higher than the average of the comparable group;[123] certainly not approximately 100 basis points lower as recommended by Dr. Klein.[124]

Additionally, a 9.5% would be far lower that what has been authorized by other regulatory commissions for CGC's affiliated LDCs operating in other states. The current returns authorized for CGC's affiliated gas distribution operations in other states with stated ROEs are as follows:

Georgia	-	10.9%[125]
Virginia	-	10.9%[126]
New Jersey	-	10.3%[127]
Florida	-	11.25%[128]

If CGC's return on equity is set too far below its current cost, as recommended by Dr. Klein, then it is quite possible that CGC will have difficulty obtaining discretionary capital from AGL. As explained by Company witness Steve Lindsey, while CGC will do everything necessary to

[121] Klein, Vol. III, Tr. 808-810.
[122] Klein, Pre-filed Direct Testimony, Exhibit 5.
[123] Dr. Klein's testimony concerning the impact of implementing revenue decoupling indicates that a drop in beta from .75 to approximately .66 would decrease AGL's cost of equity by approximately 50 basis points. *See* Klein, Pre-filed Direct Testimony, Exhibit 7; Vol. III, Tr. 822. Thus, an obvious inference from this testimony is that AGL's ROE should be higher than that of a comparable group consisting of companies with lower betas.
[124] In addition, it bears nothing that Dr. Klein's own comparable group DCF analysis produced a DCF of between 9.1% and 10.9%. *See* Exhibit 3 to Dr. Klein's direct testimony. Since AGL is riskier, in terms of beta, than all but one of the companies in Dr. Klein's comparable group, it would be reasonable to set AGL's return near the top of the range indicated by Dr. Klein's own analysis.
[125] *In Re Atlanta Gas Light Company's 2004-2005 Rate Case*, Docket No. 18638 (June 10, 2005).
[126] *Application of Virginia Natural Gas, Inc. for an expedited increase in base rates*, Case No, PUE960227 (April 27, 1998).
[127] *In the Matter of the Petition of Pivotal Utility Holdings, Inc. d/b/a Elizabethtown Gas for Approval of Increased Base Tariff Rates and Charges for Gas Service and Other Tariff Revisions*, BPU Docket No. GR09030195, OAL Docket No.: PUC-03655-2009N (December 17, 2009).
[128] *In Re Application for Rate Increase by City Gas Company of Florida*, Docket No.030569-GU (February 9, 2004).

run a safe and reliable distribution system in Tennessee, when it comes to discretionary capital decisions, the parent company may decide to invest and implement discretionary programs in jurisdictions that have more favorable opportunities to earn fair and reasonable returns on capital investments for the investors.[129]

For all these reasons, CGC's ROE should be set at a level far closer to that recommended by Dr. Morin rather than that recommended by Dr. Klein.

4. Dr. Klein's Unreasonable ROE Recommendation is the Product of Numerous Methodological Flaws.

Leaving aside the fact, demonstrated *supra*, that the end result of Dr. Klein's ROE recommendation is well outside the mainstream, the record further shows that Dr. Klein's CAPM and DCF analyses contains numerous methodological flaws that have produced this unreasonable end result. While it is certainly appropriate and reasonable to use the CAPM and DCF methodologies (as well as the historical risk premium method) to estimate the cost of equity, Dr. Klein's failure to utilize the proper inputs or consider reasonable alternative forms of those analyses has produced unreasonable results in this case.

In this regard, the primary flaw in Dr. Klein's CAPM methodology is his failure to use a risk-free rate that appropriately captures the long term nature of a typical investment in equity. While Dr. Morin utilized the current yield on 30-year U.S. Treasury bonds in his CAPM analyses, Dr. Klein utilized the yield on 90-day treasury bills and the yield on 5-year treasury notes as proxies for the risk-free rate.[130] Dr. Klein's risk-free rate proxies are unreasonable because they fail to capture the costs that would be embodied in a long term investment, including expected inflation over the long term. As Dr. Morin explained, the expected return on

[129] Steve Lindsey, Vol. I, Tr. 74:13- 75:24.
[130] Morin, Pre-filed Rebuttal Testimony, at 12, L. 21 through 13, Line 2; Klein, Pre-filed Direct Testimony, Exhibit 5.

common stocks is based on very long term cash flows. As a consequence, the yield on very long term bonds is the best measure of the risk-free rate.[131] The TRA has previously recognized that interest rate on long term treasury securities is the appropriate proxy for the risk-free rate in the CAPM.[132]

Dr. Klein recognized that common equity is generally considered a long term investment.[133] He also recognized that investors in long term securities require compensation not only for expected inflation but also for the possibility that their inflation expectations will prove to be too low.[134] Finally, Dr. Klein acknowledged that during periods of low interest rates and low inflation such as exist today, the risk premium demanded by equity investors tends to expand as compared to historical norms.[135] Unfortunately, while Dr. Klein recognized all of these principles, his CAPM methodology failed to utilize an appropriate risk free rate consistent with these principles. Dr. Klein's failure to utilize an appropriate risk free rate caused his CAPM results to be understated by between 185 and 440 basis points.[136]

Dr. Klein's CAPM analysis is also flawed because of his failure to recognize the need to consider the results of the more refined version of the CAPM – the E-CAPM – as described and supported by Dr. Morin. As Dr. Morin explained in his direct and rebuttal testimony, there have been numerous tests of the CAPM that have determined that the risk-return relationship is not as steeply sloped as is predicted by the traditional CAPM. In other words, low beta securities such as the utility stocks in the comparable groups used by Dr. Morin and Dr. Klein tend to earn

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[131] Morin, Pre-filed Rebuttal Testimony, at 13, L. 18-22.
[132] *See In Re Petition of Chattanooga Gas Company for Approval Of Adjustment of Its Rates And Charges And Revised Tariff*, Docket No. 04-00034, 2004 Tenn. PUC LEXIS 323, 236 P.U.R. 4th 1 (October 20, 2004).
[133] Klein, Vol. III, Tr. 811:7-20.
[134] Klein, Vol. III, Tr. 811:23-812:13.
[135] Klein, Vol. III, Tr. 810:15-811:6.
[136] Morin, Pre-filed Rebuttal Testimony, at 13, L. 5-8.

returns higher than those predicted by the CAPM.[137] The validity of the E-CAPM has been recognized in at least one other jurisdiction.[138] Dr. Klein's failure to recognize the E-CAPM, by itself, understates his CAPM results by about 50 basis points.[139]

Dr. Klein's ROE result was also understated as a result of his unreasonable failure to consider the results of the historical risk-premium analyses as presented by Dr. Morin. As Dr. Klein recognized on cross-examination, it is a basic principal of finance that an entity's current cost of equity must be greater than its current cost of long term debt.[140] Moreover, Dr. Klein agreed that the current period of low interest rates and low inflation tends to expand the risk premium.[141] In view of the fact that the current yield on long term debt for an investment rated utility is between 6.0% and 6.25%,[142] it is or should have been readily apparent that Dr. Klein's CAPM-derived cost of equity estimates, which ranged between 5.34% and 8.00%,[143] and his AGL-specific DCF, which indicated a cost of equity as low as 7.5%, were objectively unreasonable and should have been ignored.

Turning to Dr. Klein's DCF analysis, the record shows that this analysis also produces understated results due to methodological flaws. In this regard, the most significant flaw in Dr. Klein's DCF analyses was his reliance upon growth forecasts that are below current estimates. As Dr. Morin pointed out on rebuttal, simply updating the forecasts of earnings growth prepared

[137] Morin, Pre-filed Rebuttal Testimony, at 15, L. 4-20; Morin, Pre-filed Direct Testimony, at 26, L. 10 through 29, L. 10, Appendix A.
[138] *See, e.g.,* Case 91-M-0509 – *Proceeding on Motion of the Commission to Consider Financial Regulatory Policies for New York State Utilities*, Recommended Decision (July 19, 1994) at 50-51.
[139] Morin, Pre-filed Rebuttal Testimony, at 15, L. 14-16.
[140] Klein, Vol. III, Tr. 810:5-9
[141] Klein, Vol. III, Tr. 810:15-811:6.
[142] Klein, Vol. III, Tr. 812:14-20.
[143] Klein, Pre-filed Direct Testimony, at Exhibit 5.

by Value Line and the current analysts' consensus growth rates prepared by Zacks would increase Dr. Klein's DCF-derived cost of equity result by about 45 basis points.[144]

In addition, Dr. Klein's use of Value Line dividend growth estimates as a proxy for the growth factor used in his DCF analysis contributes to his unreasonably low ROE recommendation. The Value Line dividend growth estimates used by Dr. Klein were obtained from the December 11, 2009 issue of Value Line's "Ratings and Reports."[145] Value Line's projected growth rates cover the coming 3 to 5 years and are computed from an average figure for the past 3 years to an average figure for the future 3 year period.[146] As Dr. Klein agreed, the current dividend growth rates are generally lower than the growth rates that have been projected in the past.[147] While it is difficult to say with certainty why Value Line's dividend growth rates have declined, it is likely that the combination of gas distribution companies' need to retain cash to finance capital expenditures, the uncertainty created by the recent worldwide financial crisis, and the need of utilities to ensure their ability to maintain flexibility to finance purchases of gas in the face of volatile prices all contribute to a decline in Value Line's projection of dividend growth. While AGL's dividend payout ratio averaged approximately 60% of net income during the period 2007-2009, AGL's 10-K for the fiscal year 2009 indicates that AGL will seek to maintain a dividend payout ratio that is consistent with the payout ratios of its peer companies, which currently average approximately 63%.[148] Thus, it is reasonable to conclude that dividend growth rates will likely track earnings growth rates and be somewhat higher in the future. The use of the Value Line dividend growth rates utilized by Dr. Klein likely underestimates future growth and the resulting cost of equity.

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[144] Morin, Pre-filed Rebuttal Testimony, at 10, L. 18 through 11, L. 8.
[145] *See* the Consumer Advocate's response to CGC's discovery request Nos. 78, 79, 80 and 81.
[146] *See* the Consumer Advocate's response to CGC's discovery request No. 76.
[147] Klein, Vol. III, Tr. 797:18-798:1.
[148] *See* AGL's 2009 10-K, at 50.

In addition, Dr. Klein's DCF analysis reflects two other methodological errors that further contribute to his unreasonably low ROE recommendation. First, Dr. Klein failed to multiply the spot dividend yields used in his DCF calculations by one plus the expected growth rate (1+g). As Dr. Morin explained, one of the fundamental assumptions of the DCF methodology is that dividends are received by investors annually at the end of each year and that the first dividend is to be received one year from now.[149] Dr. Klein's failure to follow the correct methodology underestimates his ROE recommendation by approximately 30 basis points.[150]

Dr. Klein also failed in his DCF analysis to account for the fact that most utilities pay dividends quarterly and therefore a quarterly DCF model, rather than the annual model relied upon by Dr. Klein, should be used to properly gauge investor expectations.[151] To use an analogy, when banks publish the rates offered on customer deposits they typically post both the nominal rate of interest as well as the actual, typically higher rate that results from the fact that interest may be compounded on a daily, monthly or quarterly basis. The expectation of the investor is that he or she will receive the higher compounded rate, not the lower nominal rate. Dr. Klein's failure to incorporate this principal into his DCF estimate results in an analysis that fails to properly measure investor expectations of the cost of equity and understates his DCF estimate by approximately 20 basis points.

In sum, while we have already demonstrated that the end result of Dr. Klein's analyses is a recommended ROE that is well below objective indicators of the range or reasonableness, the foregoing discussion demonstrates that Dr. Klein's understatement of the cost of equity results from a number of methodological flaws. Correction of these flaws would have caused Dr. Klein to recommend an ROE that would have been close to Dr. Morin's recommendation.

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[149] Morin, Pre-filed Rebuttal Testimony, at 8, L. 22 through 9, L. 1.
[150] *Id.* at 9, L. 6.
[151] *Id.* at 9, L. 11 through 10, L. 5.

5. Dr. Klein's Analysis Unreasonably Ignores the Impact of Flotation Costs.

As a result of Dr. Klein's exclusion of flotation costs, all of his cost of equity estimates are underestimated by 30 basis points.[152] Although, Dr. Klein agreed that flotation costs must be recovered, he recommended no adjustment for these costs.[153] In his supplemental direct testimony at the hearing, Dr. Klein clarified his position on flotation costs as follows:

> My position is that this adjustment for flotation costs is small. Again, we're in kind of the same ballpark. Thirty basis points or less adjustment. But my position is that there are other factors that go in the opposite direction that offset the need for flotation costs. If we take these into account, we don't need to adjust for flotation costs.[154]

Dr. Klein's recommendation concerning flotation costs should be rejected. In his direct testimony, he identified two factors that allegedly offset the need to recover flotation costs: (1) the lack of an adjustment to reflect the quarterly payment of dividends, and (2) his perception that the dividend yields reflected in his DCF results were higher than what they are now.[155]

Contrary to Dr. Klein's suggestion, neither of his proposed reasons for rejecting an adjustment for flotation costs withstands scrutiny. First, with respect to the quarterly payment of dividends, Dr. Klein has it backwards. As we have already explained, the fact that utilities pay dividends quarterly increases the cost of equity; it does not decrease it.[156] Thus, this factor provides no basis to decline to adjust CGC's ROE to reflect flotation costs.

Second, the decline in dividend yields alluded to by Dr. Klein is not detailed, and, in any case, is likely more than offset by the increase in growth rates discussed in Dr. Morin's

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[152] *Id.* at 3.
[153] Klein, Pre-filed Direct Testimony, at 16.
[154] Klein, Vol. III, Tr. 773-774.
[155] Klein, Pre-filed Direct Testimony, at 16.
[156] Morin, Pre-filed Rebuttal Testimony, at 9-10.

rebuttal.[157] There is simply no record support for Dr. Klein's position that the impact of flotation costs should be ignored.

6. Dr. Klein Unreasonably Ignores the Relationship Between His Proposed Capital Structure and His Recommended ROE.

Dr. Klein is recommending a capital structure for CGC that contains less equity than his comparable group of companies. As explained in Dr. Morin's rebuttal testimony, the average common equity ratio is 53% (inclusive of short term debt) for Dr. Klein's group of comparable companies.[158] However, Dr. Klein is recommending a 48% common equity ratio (inclusive of short term debt) for CGC.[159] Dr. Klein has not increased his proposed 9.5% ROE to reflect the higher relative risk associated with CGC's more leveraged capital structure.

It is a fundamental tenet of finance that the greater the debt ratio, the greater the return required by equity investors in order to compensate for the additional financial risk caused by the greater use of debt financing.[160] As explained in Dr. Morin's pre-filed rebuttal testimony, based on empirical studies, equity return requirements increase between 7.6 and 13.8 basis points for each increase in the debt ratio of one percentage point.[161] There is a 5% difference between the common equity component of Dr. Klein's proposed capital structure for CGC (48%) and the common equity component of the average capital structure for the industry as seen in his comparable group (53%). Therefore, somewhere between 38 basis points (7.6 x 5) and 69 basis points (13.8 x 5) must be added to Dr. Klein's recommended ROE to reflect CGC's more leveraged capital structure.[162] While more recent studies indicate that the upper end of this range is more indicative of the effect on required equity returns, Dr. Morin points out that had Dr.

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[157] *Id.* at 10-11.
[158] Morin, Pre-filed Rebuttal Testimony, at 16-17 & Table 3.
[159] *Id.* at 16.
[160] *Id.* at 17.
[161] *Id.* at 18.
[162] *Id.*

Klein used the midpoint of 53 basis points, his ROE would have increased to 10.03% for this correction alone.[163]

As discussed *supra*, it is the Company's position in this case that its recommended capital structure should be adopted for ratemaking purposes. However, if this proposal is rejected, the ROE should be adjusted to account for the presence of more debt in the capital structure.

7. Dr. Klein's AUA Adjustment is Clearly Overstated and the Product of A Deeply Flawed Methodology.

If the TRA adopts the Company's proposed AUA mechanism or some other decoupling mechanism, Dr. Klein proposes a 50 basis point reduction to his recommended 9.5% ROE resulting in a 9.0% ROE to account for what he considers to be the risk reducing effect of the AUA mechanism. This adjustment is unreasonable for several reasons. First, Dr. Klein's proposed adjustment is completely redundant and would exacerbate Dr. Klein's unreasonable proposal to establish a ROE for CGC that is among the lowest in the nation. The record shows that the impact of implementing revenue decoupling has already been reflected in the capital market data (or stock prices) upon which Dr. Klein relies.[164] Comparing Dr. Klein's comparable group of companies used on Exhibits 2-5 of his pre-filed testimony with Exhibit DPY-4 of Mr. Yardley's pre-filed direct testimony shows that AGL and all of the comparable companies except Southwest Gas are either fully or partially decoupled. Moreover, most natural gas distribution utilities have some form of revenue decoupling mechanism and/or risk mitigating rate design mechanisms, such as a straight fixed variable ("SFV") rate design or some variation of SFV rate design.[165] As a consequence, as explained by Dr. Morin, the impact of the decoupling mechanisms is already "baked in" to the comparable companies (including AGL's) market data.

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[163] *Id.* at 18-19.
[164] *Id.* at 19.
[165] *Id.*

Dr. Klein's proposed AUA adjustment unreasonably ignores the fact that the impact of revenue decoupling is already accounted for in his analysis.

In addition, even if the impact of revenue decoupling were not reflected in his comparable company data, it is nonetheless apparent that Dr. Klein's proposed adjustment is not supported by any empirical data. Dr. Klein essentially posits that implementing revenue decoupling for CGC would decrease AGLs beta of 0.75 by approximately 10%.[166] However, there is no evidence that the implementation of revenue decoupling by any other company has produced such a dramatic drop in the company's beta.[167]

In addition, when the fact that Dr. Klein purports to establish the cost of equity for AGL, not CGC, is taken into account, Dr. Klein's recommendation becomes absurd. It is inconceivable that implementing decoupling for CGC with approximately 60,000 customers will have any measurable impact on AGL's cost of equity. AGL has already implemented a form of revenue decoupling for approximately 1.8 million customers in Georgia and Virginia.[168] The incremental impact of implementing revenue decoupling for an additional 60,000 customers in CGC's service territory could not possibly drive AGL's cost of equity down by 50 basis points.[169]

Finally, leaving aside the need for or logic of Dr. Klein's proposed adjustment, the record demonstrates that the analysis performed by Dr. Klein does not utilize inputs that provide any useful information concerning the impact that revenue decoupling will have on the standard deviation in gas distribution company equity returns.[170] While Dr. Klein purported to measure

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[166] Klein, Vol. III, Tr. 822:9-17.
[167] Klein, Vol. III, Tr. 822:23 – 823-2.
[168] Yardley, Pre-filed Direct Testimony, Exhibit DPY-4; Klein, Vol. III, Tr. 813:6-12.
[169] Klein, Vol. III, Tr. 814:6-22. If adding decoupling for 60,000 customers reduces AGL's ROE by 50 basis points, by extension, implementing decoupling for 1.8 million customers should have reduced AGL's cost of equity by 1500 basis points ((1.8/60,000) x 50). This obviously does not make logical sense.
[170] Klein, Pre-filed Direct Testimony, at 17-18.

the proportional change in the standard deviation in equity returns assuming that decoupling completely removes the effect of variations in residential volumes on equity return,[171] the record shows that Dr. Klein did not review or utilize data that establishes a relationship between the reported equity returns and the levels of residential consumption included in his analysis. Dr. Klein did not know how changes in the dollar amount of equity used in his analysis contributed to the changes in ROE used in his analysis.[172] Nor did he know how changes in residential throughput affected the net income and ROE of the gas distribution companies that were measured.[173] Without this information, it is simply impossible to draw any meaningful conclusion about the impact that changes in residential consumption will have on the standard deviation of equity returns. Moreover, even if Dr. Klein's analysis utilized meaningful data, the analysis is nonetheless not statistically valid[174] and should not be used to support a wholly unsupported reduction to CGC's ROE.

In sum, Dr. Klein's analysis is statistically invalid and unsupported by any empirical support, studies, publications or common sense.[175] It should be rejected summarily.

III. OPERATING EXPENSE DISAGREEMENTS

One of the major differences between CGC and the CAPD on revenue requirement is the proposed elimination of certain operating expenses by the CAPD. As explained below, CGC believes that it should be allowed the opportunity to recover necessary costs of doing business which include the costs associated with the variable compensation component of its market level total compensation package, the costs incurred to bring this rate case (i.e., rate case costs), and the legal costs that are reasonably anticipated to occur during the attrition period.

[171] *Id.* at 18.
[172] Klein, Vol. III, Tr. 818-819.
[173] Klein, Vol. III, Tr. 820-821.
[174] Morin, Pre-filed Rebuttal Testimony, at 20; Klein, Pre-filed Direct Testimony, at 20.
[175] Morin, Pre-filed Rebuttal Testimony, at 20.

A. CGC's total compensation package for its employees includes both base pay and variable compensation and is set at the 50th percentile of the market, which is reasonable and is a necessary cost of doing business; thus, the costs associated with the variable compensation should be included in the cost of service for the attrition period.

The total compensation package for CGC's employees and for the employees of AGL Services Company ("AGSC") who perform work on behalf of CGC includes both base pay and variable compensation, which consists of the Annual Incentive Plan ("AIP") and/or the Long Term Incentive Plan ("LTIP"). The total compensation package is set at the 50th percentile, which is 100% of market.[176] The variable compensation component is not an add-on but an integral part of each employee's total compensation.[177] The costs associated with the variable compensation component of the market level total compensation package are the only costs of variable compensation that CGC is including in this rate case.

External market surveys of comparable employers are performed annually to determine reasonable and appropriate total compensation levels that will attract and retain qualified employees who can help provide safe, reliable, and quality utility service at a reasonable cost.[178] Company witness Ronald Hanson provided in Confidential Exhibits 9 and 10 to his pre-filed rebuttal testimony the annual survey summary that supports the Company's efforts to establish total compensation levels at the 50th percentile. CAPD witness John Hughes admitted at the hearing that he had reviewed these exhibits and could not dispute that the Company attempts to establish total compensation levels that are included in the cost of service at the 50th

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176 Hanson, Pre-filed Rebuttal Testimony, at 10-11.
177 Hanson, Vol. I, Tr. 128:21-25.
178 Hanson, Pre-filed Rebuttal Testimony, Confidential Exhibit RDH-9 & RDH-10.

percentile.[179] Mr. Hughes further admitted that he had not performed his own study of the compensation of comparable utilities and that he was not an expert in compensation structures.[180]

Through Mr. Hanson's testimony, CGC has shown that setting its total compensation at the 50th percentile, where 50% of the companies pay more and 50% of the companies pay less, constitutes a reasonable level of costs consistent with current market conditions and a reasonable level to include in CGC's cost of service for this rate case. To allow the Company the opportunity to fully recover these basic costs of operation, both the base pay and the variable compensation components must be included in operating expenses for the attrition period.

CGC further has shown through its testimony that including a variable compensation component in the total compensation package helps employees focus on the financial health of the Company and motivates them to control costs, enhance productivity, maximize efficiencies, and effectuate better customer service.[181] CGC has admitted that it could set base pay at the 50th percentile but believes that ratepayers are better served by including an incentive component that motivates employees to control costs and maximize efficiencies.[182] The CAPD does not contest the reasonableness of setting total compensation levels at the 50th percentile,[183] but rather contests CGC's decision to include variable compensation as part of the total compensation package. By excluding any portion of variable compensation from CGC's cost of service, the Authority would be depriving the Company the opportunity to recover the costs associated with 100% market level employee compensation.

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[179] Hughes, Vol. II, Tr. 652:1-16.
[180] Hughes, Vol. II, Tr. 641:23 - 642:11.
[181] Hanson, Pre-filed Rebuttal Testimony, at 11.
[182] Hanson, Pre-filed Direct Testimony, at 14 ("While replacing variable compensation with an increase in base salaries to fully competitive levels would have no impact on the Company's revenue requirement, efficiencies and related customer service benefits discussed previously could be adversely impacted.").
[183] Hughes, Vol. II, Tr. 642:21-23.

The CAPD does not contest the inclusion of costs associated with the base pay of CGC's employees or of AGSC's employees who perform work on behalf of CGC in CGC's cost of service for the attrition period. Further, it appears that the CAPD does not contest the recovery of the total compensation levels if they were recovered solely through base pay. Rather, the CAPD seeks to exclude only the variable compensation component of employees' total compensation, meaning 50% of the costs of the AIP and 100% of the costs associated with the LTIP.[184]

According to CAPD witness John Hughes, the primary justification for excluding 50% of AIP and 100% of LTIP is the TRA's decision in a 1996 Nashville Gas Company rate case (Docket 96-00977).[185] However, the CAPD is mischaracterizing and broadening the TRA's decision in Docket 96-00977. The 1996 Nashville Gas rate case involved Nashville Gas' Long-Term Incentive Plan which was only available for upper management and was based on financial targets being met.[186] The TRA determined that, based on the evidence presented about Nashville Gas' Long Term Incentive Plan, including the fact that it was only for upper management, both ratepayers and shareholders shared equally in the benefits derived from the Nashville Gas Long

[184] The CAPD is taking the position that, if the TRA adopts the Company's proposed AUA, then 100% of all incentive pay should be disallowed. (*See* Hughes, Pre-filed Testimony, at 7). The AUA only addresses the fluctuation of customer usage, which is one component of base rates. The AUA does not address decreases in customer growth, increases in cost of service, increases in the Company's capital investment, or increases in the Company's debt costs. (Hanson, Pre-filed Rebuttal Testimony, at 15). The TRA's decision to adopt a new rate design that aligns the Company's and the ratepayers' interests will have no affect on the Company's ability to manage operating costs; thus, it would be improper to disallow recovery of necessary operating expenses on this basis.

[185] Mr. Hughes also initially argued during the hearing on the merits that the 2006 settlement agreement in Docket 06-00175 should justify the exclusion of CGC's variable compensation. (Hughes, Vol. II, Tr. 646:21-24). Pursuant to the terms of the 2006 settlement agreement, the provisions in the agreement do not reflect the positions of any party and are not binding on the parties in asserting opposite positions in future proceedings. As explained by CGC's witnesses and by CAPD witness Terry Buckner (Vol. II, Tr. 591:2 – 592:5), when parties enter into settlement agreements, they often negotiate bottom lines. CGC was especially concerned with the dollar amount of the recovery. Intervenors often want to take policy positions in settlement agreements. Unfortunately, if the positions that parties take in settlement agreements become the basis for future decisions, this could have a chilling effect on parties wanting to enter into settlement agreements containing explanations of the exclusions for the operation and maintenance expenses or of the return on equity unless the settlement can be structured to contain only the information required by the TRA to regulate the rates that are being allowed.

[186] TRA Order in Docket 96-00977 (Feb. 19, 1997), at 12.

Term Incentive Plan, and the TRA allowed Nashville Gas to recover 50% of the costs of the Long Term Incentive Plan from the ratepayers.[187] The Court of Appeals in reviewing the TRA's decision determined that each plan should be reviewed on a case by case basis in the context of the utility's total compensation package.[188]

The CAPD is asking the TRA to apply this ruling from the 1996 Nashville Gas rate case and broaden it by eliminating 100% of CGC's LTIP. The CAPD has failed to distinguish why costs associated with CGC's LTIP require 100% exclusion. If the TRA should determine that it wishes to apply its decision from the Nashville Gas case without considering the specific facts of CGC's current case, then the TRA should allow recovery at a minimum of 50% of CGC's LTIP costs, like it allowed for Nashville Gas.

However, the facts of the present case are different from the Nashville Gas case. Through Mr. Hanson's testimony, the Company has demonstrated that ratepayers benefit 100% from the Company's variable compensation component of the total compensation package. It is important to note that CGC is only including costs for its variable compensation plans associated with bringing total compensation to approximately 100% market level. If any additional variable compensation is provided, it is not paid by the ratepayers. Additionally, CGC's LTIP is based on financial and business goals, such as earnings per share. CGC has shown that, as revenues increase, so does earnings per share.[189] As costs decrease, so does earnings per share.[190] Both situations lead to lower revenue requirement for the Company and clearly impact the rates for customers.[191] Reductions in costs become a permanent benefit to ratepayers once rates are re-set

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[187] *Id.*
[188] *Consumer Advocate Division v. Tennessee Regulatory Authority; Nashville Gas Co.*, Appeal No. 01-A-01-9708-BC-00391, at 10 (Tenn. Ct. App. July 1, 1998).
[189] Hanson, Pre-filed Rebuttal Testimony, at 11.
[190] *Id.*
[191] *Id.*

during a rate case proceeding.[192] Any benefits that shareholders receive from reduced costs are only temporary while ratepayers receive 100% of the benefits on a permanent basis once rates are re-set.[193] Thus, CGC should be allowed the opportunity to recover 100% of the costs associated with the LTIP component of total compensation going forward. The CAPD has presented no differing opinion other than CAPD witness John Hughes' testimony that earnings per share only benefits shareholders and that if earnings per share increases only ratepayers who are stockholders will benefit.[194] Mr. Hughes has no opinion on whether ratepayers benefit if the Company is able to attract more capital into the business or whether ratepayers benefit if operating costs of the utility decrease causing its earnings per share to increase.[195] In fact, Mr. Hughes admitted that he is not an expert on stock prices or earnings per share.[196] Based on this admission, Mr. Hughes opinion testimony regarding earnings per share should be disregarded.

CGC has presented facts demonstrating that ratepayers benefit 100% from its total compensation package including its LTIP. CGC has further shown that it has set total compensation which includes variable compensation at the 50th percentile which is reasonable. Therefore, all of the costs associated with the LTIP ($189,359) should be included in the Company's cost of service for the attrition period so that CGC has the opportunity to recover these costs which are necessary costs of doing business.

Contrary to the CAPD's position, the 1996 Nashville Gas case does not justify the elimination of 50% of the AIP. In fact, the Nashville Gas case did not involve AIP type plans in which all employees participate and receive variable compensation based primarily upon obtaining individual performance goals. All employees of CGC and AGSC who perform work

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192 *Id.* at 14.
193 *Id.*
194 Hughes, Vol. II, Tr. 648:3-17.
195 Hughes, Vol. II, Tr. 648:18 - 649:5.
196 Hughes, Vol. II, Tr. 648:25 – 649:1.

on behalf of CGC participate in the AIP.[197] Approximately 60% of the AIP for CGC is based on individual performance measures such as safety, customer service, operating efficiency, and compliance.[198] The CAPD has agreed that all employees who work for CGC or AGSC on behalf of CGC participate in the AIP, and that the majority of the goals of the AIP for CGC are based upon measures such as safety and customer service.[199] Since ratepayers receive full and direct benefit from CGC's compensation structure which enhances customer service and minimizes costs, 100% of the costs associated with the AIP should be included in the Company's cost of service. Therefore, $62,556 for CGC's employees and $148,036 for AGSC employees who work on behalf of CGC must be added to the CAPD's proposed operations and maintenance expenses as set forth in Exhibit RDH-5, Schedule 5 and Exhibit RDH-8 of Ronald Hanson's pre-filed rebuttal testimony.

As explained by Company witness Ronald Hanson, other jurisdictions in which CGC's affiliate LDCs operate allow recovery of the variable compensation component of total compensation.[200] For example, both Georgia and Virginia allow full recovery. The commissions in these jurisdictions have reviewed the variable compensation plans which are the same as CGC's and have determined that it is proper to include the costs associated with this component of total compensation in the operating costs for the attrition period.

Regulatory decision making should not drive poor business decisions. A compensation plan with a variable component is the correct compensation model to promote efficiencies and good services for a regulated utility's customers, and CGC should be allowed to utilize this model as long as the total compensation remains at or below market rates. Not allowing CGC to

[197] Hanson, Pre-filed Rebuttal Testimony, at 12.
[198] *Id.* at 11.
[199] Hughes, Vol. II. Tr. 643:4-21.
[200] Hanson, Vol. I, Tr. 142:14-17.

recover compensation costs up to market levels may have the effect of driving it to change from its current compensation model which CGC believes provides for a better managed company to a compensation plan that includes only base pay.

B. Since a rate case proceeding is the only mechanism available to CGC for setting rates, CGC should be afforded the opportunity to recover the full amount of rate case costs incurred to bring this case, which are normal operating costs of a regulated utility.

CGC is including $210,667 as the amount of rate case costs for the attrition period.[201] The CAPD has taken the position that CGC should not be allowed to recover 50% of these rate case costs through base rates. It is the Company's position as presented by Company witness Archie Hickerson that regulatory costs (or rate case expenses) are part of the normal business costs of a regulated utility's business.[202] The CAPD through the testimony of Terry Buckner agrees that rate case costs are normal operating costs of a utility.[203] The only way that CGC's rates can be set is through a rate case proceeding resulting in CGC's incurring costs to prepare and present its case to the Authority.[204] Therefore, regulatory costs (or rate case expenses) should only be excluded from the expenses of the attrition period if they are deemed not to have been prudently incurred. Mr. Hickerson testified in response to questions by the Authority that, in his years of service with the Public Service Commission (the predecessor agency to the

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[201] At the April 12, 2010 hearing on the merits, counsel for the CAPD questioned Company witness Ronald Hanson about the amount of unamortized rate case costs from the 2006 settlement. Unfortunately, the CAPD did not discuss this question with Mr. Hanson or Mr. Hickerson during the many exchanges of information and discussions that occurred between the CAPD's and CGC's technical experts in this case. After Mr. Hanson's subsequent review as promised during the hearing, the Company has determined that, while the 2006 settlement agreement is unclear about the period of time over which the settled amount of rate case costs was to be amortized, three (3) years although not actually used by the Company might have been the appropriate amortization period since the Company was required to bring a rate case on or before May 28, 2010. Therefore, the Company is withdrawing its request to amortize the $89,706 of remaining unamortized rate case expense from the 2006 rate case. This results in a reduction of the $240,569 amount of rate case costs requested by CGC to $210,667 (which is an increase of $104,131 in the CAPD's included rate case costs of $106,536). *See* Hanson, Pre-filed Rebuttal Testimony, Workpaper 4 & Revised Workpaper 4 attached hereto.

[202] Hickerson, Vol. I, Tr. 356:11-13.

[203] Buckner, Vol. II, Tr. 547:12 - 548:1.

[204] Hickerson, Vol. I, Tr. 356:11-13.

Authority), he never took the position that regulatory expenses were not allowed to be recovered.[205] While Mr. Hickerson could not remember ever challenging rate case expenses, he testified that the only basis that he believes could support a challenge to rate case expenses would be a finding that these expenses were not prudently incurred.[206]

CGC has prudently incurred the rate case costs that it has included in its attrition period forecast. First, CGC was required to bring the current rate case on or before May 28, 2010 as part of its settlement with the CAPD in its 2006 rate case.[207] In bringing the current case, the Company had to incur certain costs that were necessary to develop and present its case to the Authority. Second, as part of the settlement agreement of the 2006 case, the Company was required to incur costs to conduct a depreciation study which has been accepted and agreed to by the CAPD in the current case.[208] Third, the Company has engaged legal counsel to represent it in this contested case proceeding. The CAPD has acknowledged that hiring legal counsel is a necessary cost of bringing a rate case and has acknowledged that the CAPD has five different attorneys who were involved with and signed pleadings during the course of this rate case.[209] Fourth, the Company has incurred costs to engage a cost of capital expert. The CAPD likewise has engaged a cost of capital witness and has agreed that such an expense is a necessary cost of bringing a rate case.[210] Fifth, the Company hired an expert to conduct a class cost of service study for use in designing rates, which is a reasonable cost of bringing a rate case.[211] Lastly, the Company has incurred costs associated with having an actuarial study conducted to determine

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[205] Hickerson, Vol. I, Tr. 356:1-20. The CAPD's questioning of Mr. Hickerson implied that a portion of rate case costs should be disallowed if the Company is not awarded the entire or close to the amount of the revenue deficiency that it is seeking in a rate case. Mr. Hickerson explained that the Commission had not taken that position in the 1990s when BellSouth sought close to 200 million dollar rate increases.
[206] *Id.*
[207] Hanson, Pre-filed Rebuttal Testimony, at 17.
[208] *Id.*
[209] Buckner, Vol. II, Tr. 545:22 – 546:19.
[210] Buckner, Vol. II, Tr. 545:15-21.
[211] Hanson, Pre-filed Rebuttal Testimony, at 17; *see also* TRA Filing Guideline Item No. 55.

the forecast funding requirements for pensions and the expense forecast for postretirement benefits other than pensions. The CAPD has agreed that this is a valid expense incurred to bring a rate case.[212] The Company must be allowed to recover these costs that were prudently incurred and that were necessary to bring this rate case which was required by the 2006 settlement agreement with the CAPD.[213]

Since at least the Company's 2004 rate case, the CAPD has been taking the position that the TRA should not allow utilities to include rate case costs as part of the cost of service that is recoverable through base rates. In the Company's last rate case that proceeded to hearing (Docket 04-00034), the TRA disregarded the CAPD's arguments and determined that the Company had made the rate case filing in good faith and thus its rate case expenses were recoverable.[214] Regardless of the fact that the TRA's findings and decisions in each rate case are specific to the facts and circumstances of each case and the CAPD has acknowledged this to be the case[215], the CAPD bases its current position for excluding 50% of CGC's rate case costs in this current rate case on the TRA's Order in a Tennessee American Water Company ("TAWC") rate case (Docket 08-00039). The CAPD is in essence asking the TRA to make the decision in Docket 08-00039 – that only 50% of rate case expenses were recoverable from TAWC's ratepayers – the policy of the TRA applicable to all regulated utilities regardless of the specific facts of each utility's rate case. It would not be proper for the TRA to adopt policy to be applied to all utilities based on one company's contested case. Additionally, the TRA's Order in Docket 08-00039 is currently on appeal and is pending before the Tennessee Court of Appeals.

[212] Buckner, Vol. II, Tr. 546:20 – 547:3.
[213] The CAPD questions the increase in the rate case costs from the 2006 rate case. In 2006, CGC estimated that it would incur $300,000 in rate case costs. As explained by Mr. Hanson, this was only an estimate. (Hanson, Vol. I, Tr. 152:5-11). The Company's actual rate case costs exceeded the estimated amount of $300,000 and that case settled early before rebuttal testimony was filed. In the current case, the Company has put together a more reasonable estimate of actual rate case costs that will be incurred in the present case.
[214] Order (entered Oct. 20, 2004) in Docket 04-00034, at 19-20.
[215] Buckner, Vol. II, Tr. 548:8-13.

The TRA's decision in that case was predicated on costs incurred by TAWC in filing two contentious rate cases in back-to-back years, which involved many non-routine rate case issues such as Sarbanes Oxley management audit issues. The TRA should not allow the facts in a very contentious water company case to be extended as policy of the TRA to disallow rate case costs without considering the facts surrounding the prudency of the costs incurred. CGC has not brought a rate case in back-to-back years. In fact, it has been over three years since CGC filed its last rate case. The costs that CGC has incurred to bring its current rate case were necessary costs for bringing a rate case and were prudently incurred by the Company.

It is a fundamental principle of ratemaking that a utility should be authorized to earn a fair and reasonable rate of return which consists of the cost of service for operating the utility (i.e., operation and maintenance expenses, depreciation expenses, taxes) and a reasonable return to attract capital.[216] Regulatory expenses (or rate case costs) are included as part of the cost of service of the utility. Shareholders only receive benefits or a return after all of the costs of service are recovered. Thus, any benefits that a shareholder receives from the regulated utility are a result of any reasonable return that the TRA authorizes and the Company actual earns, not a result of the Company's recovery of the cost of service of the utility.[217]

CGC has acted in good faith in bringing this rate case which it was required to bring as a result of a settlement with the CAPD. CGC has incurred necessary costs for bringing this rate case, and these costs have been prudently incurred. Therefore, CGC requests that the TRA allow it to include the full amount of rate case expenses (i.e., $210,667) in the Company's cost of service.

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[216] Buckner, Pre-filed Testimony, at 9-10.
[217] Hanson, Vol. I, Tr. 164:20 – 166:4.

C. The Company has forecast the appropriate level of legal costs that it expects to incur during the attrition period. These costs are known and measurable, and they are normal operating costs of a regulated utility.

The Company is proposing to recover through base rates the legal costs that it anticipates will be incurred during the attrition period (i.e., $590,821). This means that an additional $396,208 must be added to the CAPD's proposed level of $194,613 as set forth in Exhibit RDH-5, Schedule 5 and Exhibit RDH-8 of Ronald Hanson's pre-filed rebuttal testimony. In making this determination, management of the Company looked at the amount of legal costs included in the test year and considered the regulatory and other legal activity that is expected to occur during the attrition period. This includes legal services to be incurred for any FERC matters, tax issues, or other general corporate or employment type litigation matters. As explained by Mr. Hickerson, based on the current litigious regulatory environment and based on the Company's expectation of having several contested case dockets in which the CAPD will likely intervene, the Company believes that $590,821 is a reasonable estimate of legal costs that will be incurred during the attrition period.

The CAPD is asking the TRA to use a different test period to determine legal costs for the attrition period rather than using the test year ending December 31, 2009 and making adjustments if appropriate. Instead, the CAPD is requesting that a three (3) year historical average of legal costs for 2005, 2006, and 2007 be used for the forecast of legal costs during the attrition period. Using the CAPD's proposed 3 year historical average from 2005-2007 will result in the inclusion of only $194,613 for legal costs in the Company's cost of service.

CGC disagrees with using a three (3) year historical average of financial data that is over four years old.[218] The CAPD's proposal is contrary to its own arguments throughout this rate

[218] Hanson, Pre-filed Rebuttal Testimony, at 18.

case for using the most current data based on a test year ending December 31, 2009.[219] If the TRA believes that a three (3) year historical average is the appropriate test year to use, CGC requests that the TRA use the most recent three (3) years of data available for the years 2007-2009. As discussed by Company witness Ronald Hanson in his rebuttal testimony, the appropriate amount of legal costs to include in the attrition period would be $434,199 if the TRA chooses to adopt a three (3) year historical average approach.[220]

As admitted by CAPD witness Terry Buckner, during 2005, 2006, and 2007 there were no CGC contested cases in which the CAPD intervened other than the 2006 rate case.[221] Therefore, the legal costs incurred by CGC for those years do not accurately reflect what the Company's legal costs are when the Company is involved in a contested case in which the CAPD intervenes. By way of contrast, the legal costs for 2008 and 2009 included CGC's involvement in numerous dockets in which the CAPD intervened, including CGC's asset management docket (07-00224), CGC's asset management contract approval docket (08-00012), the generic contested case docket to evaluate funding mechanisms for energy conservation research (08-00064), and the docket to evaluate the appropriateness of implementing the PURPA standards (09-00065).

The Company anticipates that there will be numerous upcoming contested case dockets in which the CAPD will seek to intervene. As explained by Mr. Hickerson, the Company expects a docket(s) to be convened regarding the issuance of an RFP for a new asset management agreement and awarding a new asset management agreement.[222] Based on the position taken by

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[219] *See, e.g.,* Buckner, Vol. II, Tr. 578:15-25.

[220] Hanson, Pre-filed Rebuttal Testimony, at 19. The Company incurred $527,498 in legal expenses during 2008 and $578,479 during 2009.

[221] Buckner, Vol. II, Tr. 553:5 – 555:23.

[222] Hickerson, Vol. I, Tr. 343:21 – 344:6. After developments during the hearing on the merits, CGC approached its asset manager Sequent Energy Management and asked Sequent to extend the current asset management agreement for four years pursuant to its terms. While CGC was willing to extend its current asset management agreement,

the CAPD in Docket 07-00224, the Company expects any new docket involving asset management issues to be equally litigious, especially when the CAPD has continued to try to raise allegations about CGC's asset management arrangement even during this current rate case, which the TRA has determined is not relevant to this rate case proceeding.[223] Mr. Hickerson discussed the CAPD's request during the current rate case for the TRA to adopt a uniform protective order that would apply to all utilities and the Hearing Officer's recommendation for the TRA to open a separate docket, which the Company anticipates to be an extensive docket.[224] The Authority has also opened a docket to explore the TRA's notice requirements for rate case proceedings.[225] These contested case proceedings that are known to be occurring during the attrition period justify setting legal costs at a level greater than the historical average for 2005-2007 as proposed by the CAPD.

Finally, contrary to the arguments made by the CAPD, CGC is not double recovering for the costs incurred in Docket 07-00244. As explained in Section IV. herein, CGC is seeking to recover litigation costs from that docket through a proposed rider. CGC is forecasting that its legal costs for the attrition period will continue to be at levels consistent with the amount of legal costs incurred during the 2009 test year.[226] As explained by Mr. Hickerson, this is the most litigious atmosphere that he has ever been involved in during his 34 years of experience in regulation in Tennessee,[227] and there is no reason to believe that the litigious regulatory environment will not continue during the attrition period. Mr. Hickerson explained that, when the Division was first established, he moved from the Public Service Commission to the

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Sequent declined to do so because of changed market conditions. As a result, CGC is proceeding forward with seeking approval for the issuance of an RFP for a new asset management agreement.

[223] Hearing Officer's Order Addressing Several Pre-Trial Motions (entered April 9, 2010), at 3-6; *see also* Vol. II, Tr. 605-609 (upholding the Hearing Officer's Order).

[224] Hickerson, Vol. I, Tr. 344:24 – 345:8.

[225] Hickerson, Vol. I, Tr. 345:9-10.

[226] Hickerson, Vol. I, Tr. 340:9 – 341:5.

[227] Hickerson, Vol. I, Tr. 333:21-24.

Attorney General's Office along with six other accountants and there were only two attorneys in the Division.[228] Currently, the Division has at least 5 attorneys who have signed pleadings in this current rate case.[229] This change in management has shifted the focus from the facts driving the cases to much time and resource being expended on procedural arguments and litigation.[230] The primary focus of the Division's work at the time of Mr. Hickerson's employment related to telephone companies and the Telecommunications Act of 1996.[231] After Mr. Hickerson left the Division in 2000, the regulation of telecommunications companies materially changed and most telecommunications companies currently operate under market based regulation.[232] Today, while the number of attorneys in the Division has increased, the size of the regulated community has decreased, leaving more attorneys with more time to litigate.[233]

The Company has put forth evidence to support a finding that its projection for legal expenses during the attrition period is reasonable. Further, Mr. Hickerson has testified that in his opinion the amount of legal costs included in the attrition period is accurate and reasonable,[234]

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[228] Hickerson, Vol. I, Tr. 353:15-21.
[229] Hickerson, Vol. II, Tr. 375:3-5.
[230] Hickerson, Vol. I, Tr. 353:21-25.
[231] Hickerson, Vol. II, Tr. 374:4-8.
[232] Hickerson, Vol. II, Tr. 374:12-25.
[233] A further example of the litigious environment of contested cases is the situation in the current rate case regarding the participation of out-of-state counsel. (Vol. III, Tr. 667:6 – 687:2). At approximately 3:00 p.m. on the Friday before the April 26th hearing date, the CAPD raised issues regarding the pro hac vice application filed by CGC. As explained at the hearing, while there were several telephone conversations between counsel for CGC and the CAPD on Friday, April 23rd, beginning at 11:30 a.m., the CAPD would only indicate that there would possibly be one additional issue for Monday's hearing but would not reveal the issue. Then at 3:00 p.m., counsel for the CAPD questioned via email whether CGC's application had complied with all of the requirements of Supreme Court Rule 19. *See* Email Correspondence Between the Parties and the Hearing Officer (filed April 26, 2010). CGC filed the same pro hac vice application that it has filed in other TRA proceedings and that has never been challenged by the CAPD. As indicated by the TRA at the hearing, nothing more was required by CGC. However, much time and resources were expended over the weekend and on Monday morning prior to the hearing to cure any potential challenges that the CAPD raised on Friday afternoon. This could have been done expeditiously on Friday afternoon if the CAPD had raised the issue before the courts in the Eastern Time zone had closed. Further, CGC questions why the CAPD chose to raise this issue at all when other non-Tennessee licensed lawyers frequently appear in other dockets without filing pro hac vice applications or being required by the CAPD or the TRA to meet all of the requirements of Rule 19.
[234] Hickerson, Pre-filed Rebuttal Testimony, at 10.

and that the legal costs incurred in the test period were reasonably and prudently incurred.[235] Since legal costs are a normal cost of doing business, the Company should be afforded the opportunity to include reasonable legal fees that are anticipated to be incurred during the attrition period in the Company's cost of service.

D. The CAPD has accepted the Company's depreciation study and has adopted the depreciation rates set forth in the Company's depreciation study. The full amount of depreciation expense in the amount of $5,312,911.00 has been agreed to by the Company and the CAPD conditioned upon the TRA's ordering the Company to allocate the accumulated depreciation reserve consistent with the depreciation study.

During the hearing on April 13, 2010, the Company and the CAPD reached agreement that an additional $111,480 would be included in the depreciation expense in the Company's cost of service for the attrition period.[236] The Company has agreed to allocate the accumulated depreciation reserves consistent with the depreciation study.[237] On April 26, 2010, the TRA ordered the CAPD to file corrected papers reflecting the agreement regarding the additional $111,480 in depreciation expense conditioned upon the TRA's ordering the Company to reallocate the accumulated depreciation reserves.[238] This agreement results in depreciation expenses totaling $5,312,911.00 for the attrition period as reflected in Column 5 of Exhibit RDH-5, Schedule 1 to Company witness Ronald Hanson's pre-filed rebuttal testimony.

E. The Company's practices and policies are working well and thus it is not necessary at this time to adopt the CAPD's proposed mandatory "consumer protection" recommendations for which no cost analysis has been performed.

While the CAPD has proposed "consumer protection" recommendations as an appendix to the pre-filed testimony of Mr. Buckner, the CAPD has provided no testimony explaining the need for the mandatory standards, no analysis whether any additional benefits will be provided

[235] Hickerson, Vol. II, Tr. 381:5-8.
[236] Buckner, Vol. II. Tr. 581:15 -584:4.
[237] *Id.*
[238] Vol. III, Tr. 833:16 – 835:15.

beyond what the Company is already cost-effectively providing, and no explanation of the costs that will be incurred by the Company to implement these recommendations. The CAPD admits that it has not performed any analysis of the costs that will be incurred by the Company to implement these standards.[239] As explained by Steve Lindsey, the Vice President and General Manager for CGC, the Company has under its current practices and procedures the flexibility needed to work with individual customers based on each individual's credit history and payment history to determine the best way to work with the customer and address the customer's needs while also controlling bad debt costs which will impact the overall customer base.[240] Mr. Lindsey testified that CGC's current practices and procedures are working well.[241] The CAPD has not provided any evidence to the contrary.

CGC was not able to prepare a cost analysis of the effect of the CAPD's recommendations. During discovery, CGC asked the CAPD to provide the definitions for certain terms such as "unique financial distress", "disabled", or "disabled members of customer's household" so that CGC could determine the breadth of applicability. However, the CAPD was not able to provide detailed descriptions or definitions and thus the Company was unable to reasonably estimate the number of customers who would potentially qualify.[242] It would be difficult for the Company to implement, and for the TRA to regulate, these customer protection recommendations without clearly defined terms. CGC believes that it is not necessary at this time to adopt the CAPD's proposed mandatory "consumer protection" recommendations.[243]

[239] Lindsey, Pre-filed Rebuttal Testimony, at 2; *see* CAPD's Responses to CGC's Discovery Request Nos. 5-7.
[240] Lindsey, Vol. I, Tr. 63:3-13.
[241] Lindsey, Pre-filed Rebuttal Testimony, at 5; Lindsey, Vol. I, Tr. 64:12-16.
[242] Lindsey, Pre-filed Rebuttal Testimony, at 4.
[243] *Id.* at 5.

IV. RECOVERY OF LITIGATION COSTS FROM DOCKET 07-00224

CGC should be allowed to recover through the Purchased Gas Adjustment ("PGA") the prudent litigation costs that it has incurred to defend against the CAPD's allegations in Docket 07-00224 regarding CGC's asset management arrangements and gas costs and capacity supply planning. As discussed in Company witness Archie Hickerson's pre-filed direct testimony, the Company is requesting that the Authority adopt a temporary rider that will allow CGC to recover $744,743.81 in litigation costs incurred in Docket 07-00224 through the PGA mechanism over three (3) years. These litigation costs were incurred by CGC to defend against the outrageous allegations that were brought by the CAPD and then ultimately withdrawn regarding CGC's asset manager, asset management agreement, and gas costs and capacity supply planning. Recovery of costs through the PGA was the only issue raised by the Company in Docket 07-00224. In December 2009, the Chattanooga Manufacturers Association filed a motion requesting that the cost recovery issue be transferred into this rate case. The Hearing Officer determined that "[i]n the context of a rate case, legal fees and regulatory expenses are regularly evaluated, and if considered as valid and prudent, they are included as a portion of the overall cost of service for recovery through base rates. As such, the Hearing Officer [found] that the prudency of the expenses in dispute in this matter should be considered within a rate case, and because Docket 09-00183 is presently ongoing, it is both practical and efficient to combine the request for reimbursement for such legal fees with the request for a rate increase in this docket."[244]

[244] Initial Order Granting Motion to Combine (Feb. 11, 2010), at 3-4. CGC has continued, however, to argue that the TRA could award recovery of these prudently incurred costs associated with gas and capacity related costs through the PGA, like recovery of costs for consultants who perform prudency review audits of gas and capacity related costs pursuant to TRA Rule 1220-4-7-.05. The Hearing Officer also opined that Docket 07-00224 initiated from CGC's previous rate case docket (06-00175). Mr. Buckner has testified that the Company could have recovered these legal costs in that rate case. (Buckner, Vol. II, Tr. 609:22 - 610:6).

The CAPD contends that the TRA cannot award these legal costs to CGC because of the *Kingsport Power v. Tennessee Public Service Commission*, 1984 Tenn. App. Ct. LEXIS 2949, case. As explained by Mr. Hickerson, who was employed by the Public Service Commission at the time of the cited case, the *Kingsport Power* case involved an intervenor who was seeking to recover legal costs from a utility.[245] CGC was not an intervenor in Docket 07-00224 but was a respondent to the CAPD's unfounded allegations of wrongdoing.[246] Mr. Hickerson testified that, in his experience, the Company may seek and be allowed to recover any cost that it incurs during the normal course of business and the TRA has the authority to award the recovery of these costs.[247]

CGC disagrees with the CAPD's assertion that the award of these legal costs amounts to retroactive ratemaking. Mr. Hickerson has explained that regulated utilities are allowed to defer a cost and recover it in a future period.[248] For example, the cost of a rate case is routinely deferred during the rate proceeding and amortized over a future period.[249] However, the TRA must authorize the recovery before the Company is allowed to defer it.[250] Thus, if the TRA were to allow recovery of these litigation costs, CGC could defer this amount and be allowed to amortize it over the three years as requested in this case. In fact, in the settlement agreement that was submitted to the TRA on July 8, 2009 in Docket 07-00224, the CAPD agreed that CGC could defer and recover legal costs over a three year period and did not consider it to be retroactive ratemaking at that time.[251]

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[245] Hickerson, Vol. I, Tr. 324:17-19 & 317:15 – 318:9.
[246] Hickerson, Vol. I, Tr. 317:15 – 318:9.
[247] Hickerson, Vol. I, Tr. 325:13-16.
[248] Hickerson, Vol. I, Tr. 329:23 – 330:4.
[249] Hickerson, Pre-filed Rebuttal Testimony, at 9.
[250] Hickerson, Vol. I, Tr. 330:14-20.
[251] Hickerson, Pre-filed Rebuttal Testimony, at 9.

The costs incurred by CGC in defending against the CAPD's allegations of improper dealings in its gas costs and capacity supply planning process and asset management arrangement were prudently incurred. Exhibit ARH-1 to Mr. Hickerson's pre-filed direct testimony presents a timeline of the proceedings in Docket 07-00224. Docket 07-00224 was initiated as a result of the actions of the CAPD.[252] During the Company's 2006 rate case, the CAPD raised issues relating to the sharing of gains from CGC's asset management agreement and purchased gas costs.[253] Since these issues involved the PGA and not costs recovered through base rates and were not issues routinely addressed in rate cases, the TRA ultimately moved these issues to a separate docket (i.e., Docket 07-00224).[254] The Company could not have anticipated that these non base rate issues would be raised by the CAPD in responding to CGC's 2006 petition to increase rates. The CAPD had the burden of proof in Docket 07-00224, and CGC responded and defended itself against the CAPD's allegations. In essence the CAPD was in control of the method and manner in which it chose to litigate the issues against CGC.

The CAPD has not contested the prudency of CGC's legal costs that were incurred in Docket 07-00224 until the recovery issue was transferred into the current rate case. In fact in July 2009, a settlement agreement was filed with the TRA which included a provision for CGC to recover its legal costs. It is difficult to believe that the CAPD would have agreed to the recovery of costs that it believed were not prudently incurred. Additionally, the CAPD filed a Stipulation which is attached as Exhibit ARH-3 to Mr. Hickerson's pre-filed direct testimony in which the CAPD did not contest the prudency of the Company's legal expense. The first time

[252] Hickerson, Pre-filed Direct Testimony, at 5.
[253] *Id.*
[254] Hickerson, Pre-filed Direct Testimony, at 6-7.

that the prudency of the Company's legal expenses was challenged by the CAPD was after the CAPD changed its position in January 2010 and contested the recovery of these costs.

CAPD witness Terry Buckner compares the CGC Docket 07-00224 to the Nashville Gas Docket 05-00165 in an attempt to show the unreasonableness of the costs incurred in Docket 07-00224. Mr. Buckner describes the Nashville Gas docket as being done solely voluntarily with Nashville Gas with the free exchange of information and a settlement agreement between the parties to resolve the issues.[255] However, as explained by Mr. Hickerson these dockets are not similar. The Nashville Gas docket involved the Nashville Gas Incentive Plan which deals with sharing the savings that occur when the company purchases gas at less than the benchmark price.[256] The Nashville Gas docket arose after the TRA Staff's audit of the Nashville Gas Incentive Plan for the year ending June 30, 2004, to address how the flat fee paid by the company's asset manager was to be treated in conjunction with the incentive plan. There was no testimony filed in the Nashville Gas docket that accused Nashville Gas or its asset manager of any wrongdoing like what was filed in CGC's Docket 07-00224.[257] The manner in which CGC's Docket 07-00224 commenced and proceeded was controlled by the CAPD who had the burden of proof.

Docket 07-00224 is a good example of how the procedures of litigation have become the CAPD's primary means for learning, investigating, and carrying out its duties. In December 2007, the CAPD and the TRA staff were invited and traveled to CGC's asset manager's offices to learn about the asset management process. During this visit, the Vice President of Sequent Energy Management met with the CAPD and TRA Staff representatives on a daily basis, provided access to other Sequent employees as needed, responded to all questions asked, and

[255] Buckner, Vol. II, Tr. 615:11-14.
[256] Hickerson, Pre-filed Rebuttal Testimony, at 2.
[257] Hickerson, Vol. I, Tr. 328:15-18.

provided all information requested. The Company offered the opportunity for the free exchange of information during the visit and even after. However, after the visit, the CAPD chose not to pursue additional information or understanding through informal communications between the technical experts at the CAPD's office and the Company or through a cooperative process. Rather, the CAPD decided to proceed down the litigious path and procedures of a contested case proceeding.

As explained on Exhibit ARH-1 and also by Mr. Hickerson in his testimony, the CAPD filed voluminous testimonies and exhibits.[258] In fact, the CAPD filed direct testimony, rebuttal testimony, revised direct and rebuttal testimony, and sur-rebuttal testimony. When one of the CAPD's witnesses raised new issues for the first time in his rebuttal testimony, CGC moved to have the new information removed or alternatively to have the opportunity to respond to the new allegations that were improperly raised. This led to additional testimony being filed and additional discovery. In total, the CAPD was afforded three rounds of discovery, and the Company expended much time preparing discovery responses, challenging the CAPD's efforts to broaden the scope of discovery, preparing responsive testimony, moving to strike testimony, and defending against and responding to the incorrect analysis and allegations included in the CAPD's testimony.[259] Ultimately, the CAPD voluntarily withdrew the overwhelming majority of its testimony on July 2, 2009, less than 10 days before the hearing on the merits.[260]

Unfortunately, CGC was forced to defend itself in an extremely litigious docket because the CAPD chose the process of convening a contested case to assert its allegations of improper conduct related to CGC's gas costs and capacity supply assets and relied upon its improper expert testimony for well over a year after it was filed. The CAPD could have chosen to

[258] Hickerson, Pre-filed Direct Testimony, at 13.
[259] *Id.*
[260] *Id.*

continue down the pathway initiated by CGC and its asset manager and to have asked questions and learned about CGC's asset management arrangement and gas cost and capacity supply planning process outside of a contested case proceeding but did not. As a result, CGC spent over two (2) years trying to convince the CAPD of the problems and inaccuracies in its testimony and theories and defending itself against the CAPD's allegations. At the hearing on the merits, CGC presented substantial testimony to the TRA regarding its gas costs and capacity supply planning process, and in the end, the TRA determined that CGC subscribed to an appropriate level and mix of gas supply and capacity assets.[261]

A side-by-side review of the timeline of the proceedings as set forth in Exhibit ARH-1 and the legal invoices submitted by the Company support the conclusion that the legal costs incurred by the Company were prudent as the Company did not have the burden of proof and was forced to defend and respond to the multitude of allegations initiated by the CAPD. Further, a careful review of the invoices from the months of May 2008, December 2008, and January 2009 that were contemporaneously made at the time they were incurred will reveal an accurate depiction of the efforts that the Company undertook to resolve and settle the conflict in the docket.[262] Additionally, this issue has been extensively briefed in Docket 07-00224 and those documents relating to the cost recovery issue have been moved into this docket. More specifically, CGC's Brief Regarding Cost Recovery filed on October 28, 2009 in Docket 07-0024 provides further details and explanation about the prudency of the costs incurred by CGC to defend against the CAPD's allegations. As CGC has prudently incurred these litigation costs totaling approximately $745,000 in Docket 07-000244 during the normal course of business, the

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[261] *Id.*

[262] Mr. Buckner testified that the CAPD makes every effort to settle cases. (Buckner, Vol. II, Tr. 612:22-23). However, the December 2008 and January 2009 invoices reveal how settlement negotiations may sometimes be used to gain procedural advantages rather than actual good faith settlements which caused this case to continue from the December 15, 2008 scheduled hearing on the merits until the July 13, 2009 hearing on the merits.

TRA should allow CGC to recover these costs through a per therm volumetric charge through the PGA over three (3) years.

CONCLUSION

Based on the record in this case, the Company respectfully requests that the TRA grant its petition for a rate increase to allow the Company to earn an additional $2.2 million in revenues. The Company's proposed capital structure is reasonable as it reflects known and reasonable changes in the Company's level of short term debt. The Company's proposed rate of return on the common equity capital of 10.75% if there is an alignment of interests in the rate design, or 11% if no alignment is granted, is fair and reasonable for a utility of the size and risk of CGC. The Company has presented evidence to support the recovery of the three operating expenses at issue – variable compensation, rate case costs, and legal costs during the attrition period – as being reasonable costs incurred and necessary for doing business as a regulated utility. Additionally, the Company should be allowed to recover the litigation costs that were prudently incurred in Docket 07-00224 to defend against the allegations of wrongdoing brought against the Company by the CAPD.

Further, CGC has presented to the TRA a comprehensive plan that will align the interests of its customers and its shareholders. First, the Company's proposed energySMART conservation program will provide customers with real opportunities to reduce their usage of natural gas. The energySMART program is cost effective, measurable, and verifiable. Second, the Company has proposed three different rate designs that will fully align the interests of CGC and its ratepayers while removing the disincentives that are inherent in CGC's existing rate design. The energySMART program and the proposed rate designs work in conjunction with each other to accomplish the objectives of promoting energy efficiency, reducing customer bills, conserving energy, and playing a role in energy interdependence.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on this 7th day of May 2010, a true and correct copy of the foregoing was served on the persons below by electronic mail:

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Chattanooga Gas Company
Rate Case Preperation Costs
For the Twelve Months Ending April 30, 2011 (Attrition Period)

Line No.	**Current Rate Case Preparation Costs**			
1	Depreciation Study	[redacted]		
2	Class Cost of Service			
3	General Rate Case Support			
4	Legal Costs			
5	Cost of Equity Witness			
6	Pension PBOP Estimates			
7	Total	632,002	Revised Adjustment	Three Year Amortization 210,667
8	Monthly Amortization	17,556		Amount included by CAPD 106,536
9	Amortization - 3 years	210,667		Adjustment 104,131
	Amortization of Existing Cost			
10	Balance as of April 30, 2010	89,705.70		
11	Monthly Amortization	2,491.83		
12	Annual Amortization	29,901.90		
13	Total Annual Amortization	**240,569.23**		

Accumulated Deferred Income Tax Balance

	(1) Balance for Attrition Period	(2) Beginning Balance Rate Case Costs	(3) Monthly Amortization	(4) Cost Incurred	(5) Ending Balance Rate Case Costs	(6) Federal	(7) State	(8) Total
14	31-Dec-09				326,928			
15	31-Jan-10	326,928.00	(7,985)		318,943	104,374	20,731	125,105
16	28-Feb-10	318,943.00	(7,985)		310,958	101,761	20,212	121,973
17	31-Mar-10	310,958.00	(7,985)		302,973	99,148	19,693	118,841
18	30-Apr-10	302,973.00	(7,985)	426,719.70	721,708	236,179	46,911	283,090
19	31-May-10	721,707.70	(7,985)		713,723	233,566	46,392	279,958
20	30-Jun-10	713,722.70	(7,985)		705,738	230,953	45,873	276,826
21	31-Jul-10	705,737.70	(7,985)		697,753	228,340	45,354	273,693
22	31-Aug-10	697,752.70	(7,985)		689,768	225,726	44,835	270,561
23	30-Sep-10	689,767.70	(7,985)		681,783	223,113	44,316	267,429
24	31-Oct-10	681,782.70	(7,985)		673,798	220,500	43,797	264,297
25	30-Nov-10	673,797.70	(18,717)		655,081	214,375	42,580	256,956
26	31-Dec-10	655,081.10	(18,717)		636,364	208,250	41,364	249,614
27	31-Jan-11	636,364.49	(18,717)		617,648	202,125	40,147	242,272
28	28-Feb-11	617,647.89	(18,717)		598,931	196,000	38,931	234,931
29	31-Mar-11	598,931.29	(18,717)		580,215	189,875	37,714	227,589
30	30-Apr-11	580,214.69	(18,717)		561,498	183,750	36,497	220,248
31	Attrition Period Average				656,462			

Total Estimated Costs above	632,002.00
Less actual incurred through December 31, 2009	205,282.30
Remaining Cost to be incurred	426,719.70