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BEFORE THE TENNESSEE REGULATORY AUTHORITY DOCKET ROOM

NASHVILLE, TENNESSEE

November 20, 2012

IN RE:

CHATTANOOGA GAS COMPANY  
ANNUAL INCENTIVE PLAN FILING FOR  
THE 12 MONTHS ENDED JUNE 30, 2012

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Docket No. 12-00106

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**NOTICE OF FILING BY THE UTILITIES DIVISION OF THE TENNESSEE  
REGULATORY AUTHORITY**

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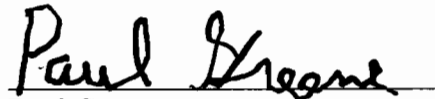
Pursuant to Tenn. Code Ann. §§65-4-104, 65-4-111 and 65-3-108, the Utilities Division of the Tennessee Regulatory Authority hereby gives notice of its filing of the Compliance Audit Report of the Performance-Based Ratemaking Tariff (hereafter "Incentive Plan") for Chattanooga Gas Company ("Company") in this docket and would respectfully state as follows:

1. The present docket was opened by the Authority to hear matters arising out of the Incentive Plan audit of the Company.
2. The Company's Incentive Plan filing was received on September 12, 2012, and the Audit Staff ("Staff") completed its audit of the same on November 13, 2012.
3. Staff noted no material findings during the course of the Incentive Plan Audit ("IPA").

4. A final IPA audit report (hereafter the "Report") resulted therefrom. The Report is attached hereto as Exhibit A and is fully incorporated herein by this reference.

5. The Utilities Division hereby files its Report with the Tennessee Regulatory Authority for deposit as a public record.

Respectfully Submitted:

A handwritten signature in black ink that reads "Paul Greene". The signature is written in a cursive style and is positioned above a horizontal line.

Paul Greene  
Utilities Division of the  
Tennessee Regulatory Authority

**CERTIFICATE OF SERVICE**

I hereby certify that on this 20<sup>th</sup> day of November 2012, a true and exact copy of the foregoing has been either hand-delivered or delivered via U.S. Mail, postage pre-paid, to the following persons:

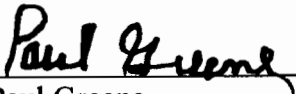
James M. Allison, Chairman  
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\_\_\_\_\_  
Paul Greene

**COMPLIANCE AUDIT REPORT  
of the  
PERFORMANCE-BASED RATEMAKING TARIFF  
(hereafter “INCENTIVE PLAN”)  
for  
CHATTANOOGA GAS COMPANY**

**Docket No. 12-00106**

**Prepared by:**

**THE UTILITIES DIVISION  
of the  
TENNESSEE REGULATORY AUTHORITY**

**November  
2012**

**EXHIBIT A**

**COMPLIANCE AUDIT REPORT**  
**of the**  
**PERFORMANCE-BASED RATEMAKING TARIFF**  
**(hereafter “INCENTIVE PLAN”)**

**for**  
**CHATTANOOGA GAS COMPANY**  
**for the Year ended June 30, 2012**

**Docket No. 12-00106**

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## **I. INTRODUCTION AND AUDIT OPINION**

This compliance audit report addresses the Performance-Based Ratemaking tariff (“Incentive Plan”) of Chattanooga Gas Company (“Chattanooga,” “CGC,” or “Company”). The audit objective is to determine whether the Company has complied with the terms and conditions of its Incentive Plan during the twelve (12) months ended June 30, 2012. After reviewing the Company’s gas purchases as reported in the Actual Cost Adjustment Audit (“ACA”) filing<sup>1</sup>, along with the applicable benchmark indexes each month, Audit Staff (“Staff”) found no material errors. Staff concludes that the Company met the criteria specified in its tariff during the plan year reviewed. Section III of the report addresses the actual results of the plan year.

## **II. BACKGROUND AND DESCRIPTION OF INCENTIVE PLAN**

On January 8, 2002, the Tennessee Regulatory Authority (“TRA” or “Authority”) issued an Order in Docket Number 01-00619 approving a tariff to establish a performance-based ratemaking mechanism for Chattanooga Gas Company. The specific details of the mechanism are included in Chattanooga Gas’ tariff entitled Performance-Based Ratemaking, which was issued on January 25, 2002 and made effective on September 11, 2001.<sup>2</sup> The tariff was revised effective February 1, 2006 in Docket No. 04-00402 to include Affiliate Transaction Guidelines, and was further revised effective September 1, 2006 to include RFP Procedures for Selection of Asset Manager and/or Gas Provider. A copy of the current tariff is attached to this report as Attachment 1. The Incentive Plan automatically rolls over for an additional plan year on each July 1<sup>st</sup>, and continues until the Incentive Plan is either (a) terminated at the end of a plan year or by not less than 90 days notice to the TRA by Chattanooga Gas or (b) modified, amended or terminated by the TRA.

Chattanooga’s tariff differs from traditional incentive plans in that the Company does not share in any profits or losses experienced when comparing its actual gas cost purchases against a predetermined benchmark. The “incentive” in Chattanooga Gas’s case is a waiver of the prudence audit of gas purchases as required under the TRA’s Purchased Gas Adjustment Rule.<sup>3</sup> The terms under which the prudence audit will be waived is found in the section Prudence Determination of the tariff (Second Revised Sheet No. 56A).

“If Chattanooga’s total commodity gas cost for the plan year does not exceed the total benchmark amount by one percentage point (1%) for a plan year ending after June 30, 2000, Chattanooga’s gas cost will be deemed prudent and the audit required by Tennessee Regulatory Authority’s Administrative Rule 1220-4-7-.05 is waived. If during any month of the plan year, the Company’s commodity gas cost

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<sup>1</sup> Docket # 12-00105.

<sup>2</sup> September 11, 2001 was the date of the Authority Conference during which the Directors voted to approve the Company’s tariff petition with certain modifications.

<sup>3</sup> TRA Rule 1220-4-7-.05.

exceeds the benchmark amount by greater than two percentage points (2%), the Company shall file a report with the Authority fully explaining why the cost exceeded the benchmark.”

The Company first put its asset management contract out for bid following the approved Request for Proposal (“RFP”) procedures and brought the fully executed contract before the TRA for approval in Docket No. 08-00012. The TRA approved the contract at its February 25, 2008 Authority Conference to become effective April 1, 2008 as requested by the Company. This contract expired on March 31, 2011.

Docket No. 10-00049 was opened upon the filing by CGC on March 31, 2010 notifying the Authority of its intention to issue a RFP for asset management services pursuant to its tariff on or before May 11, 2010. On April 23, 2010, CGC filed a letter reporting that due to the changing market conditions, Sequent Energy Management<sup>4</sup> (“Sequent”) declined to renew the current contract under its current terms because of the amount of the annual guaranteed minimum. The RFP requested a flat rate bid. Sequent was the successful bidder for the new Agreement. The Agreement became effective April 1, 2011 and will expire on March 31, 2014 unless either party gives a one year notice to extend the term up to one year. The extension must be mutually agreed upon by the parties and approved by the TRA.

During the reporting period which is the subject of this audit, Sequent was CGC’s asset manager. The terms of the asset management agreement provided that Sequent would supply CGC’s gas requirements and manage its assets. Fifty percent (50%) of the proceeds realized by Sequent under the agreement are refunded to the utility’s customers via the Interruptible Margin Credit Rider (“IMCR”) tariff.<sup>5</sup> Benefits accruing to customers during the audit period are explained more fully in Section III, ACTUAL PLAN YEAR RESULTS.

On September 26, 2007, the Authority opened Docket 07-00224 to evaluate Chattanooga’s gas purchases, asset management activities and related sharing mechanisms. A Hearing on these matters was held on July 13, 2009. The panel in its order dated October 13, 2009, determined that a triennial comprehensive review of the Company’s capacity planning and gas purchasing activities as encompassed in the Incentive Plan shall be performed by an independent consultant, the first review to commence in the fall of 2013. Subsequent reviews, if necessary, shall be conducted at the order of the Authority.

### **III. ACTUAL PLAN YEAR RESULTS**

On September 12, 2012, Chattanooga filed an annual report as required by its tariff, showing the actual cost of gas invoiced by its affiliate Sequent and other suppliers and the applicable benchmark index for each purchase during each month of the plan year

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<sup>4</sup> Sequent is the unregulated marketing arm of AGL Resources, Inc., the parent company of Chattanooga Gas and therefore, an affiliate of Chattanooga.

<sup>5</sup> Under the IMCR tariff, the utility does not share in the 50% of proceeds that are refunded to customers.

ending June 30, 2012. Staff reviewed Sequent invoices and other supplier invoices filed as part of the Company's ACA audit, and the indexes<sup>6</sup> used to calculate the benchmark each month. The table below summarizes the Company's monthly purchases as compared to the calculated monthly benchmarks.

<b>Cost of Gas</b>			
<b>Month</b>	<b>Actual Purchase Cost</b>	<b>Benchmark Cost</b>	<b>Percentage Over/(Under) Benchmark</b>
<b>July 2011</b>	<b>\$3,304,676.75</b>	<b>\$3,308,980.47</b>	<b>-0.1301%</b>
<b>August 2011</b>	<b>\$2,022,941.16</b>	<b>\$2,024,029.84</b>	<b>-0.0538%</b>
<b>September 2011</b>	<b>\$2,363,593.78</b>	<b>\$2,367,941.16</b>	<b>-0.1836%</b>
<b>October 2011</b>	<b>\$2,696,398.60</b>	<b>\$2,697,312.61</b>	<b>-0.0339%</b>
<b>November 2011</b>	<b>\$2,180,434.72</b>	<b>\$2,174,073.85</b>	<b>0.2926%</b>
<b>December 2011</b>	<b>\$2,476,449.63</b>	<b>\$2,474,339.20</b>	<b>0.0853%</b>
<b>January 2012</b>	<b>\$2,189,057.62</b>	<b>\$2,188,118.44</b>	<b>0.0429%</b>
<b>February 2012</b>	<b>\$664,615.65</b>	<b>\$664,030.52</b>	<b>0.0881%</b>
<b>March 2012</b>	<b>\$467,191.70</b>	<b>\$463,394.53</b>	<b>0.8194%</b>
<b>April 2012</b>	<b>\$1,140,441.59</b>	<b>\$1,142,886.78</b>	<b>-0.2139%</b>
<b>May 2012</b>	<b>\$970,480.36</b>	<b>\$976,045.56</b>	<b>-0.5702%</b>
<b>June 2012</b>	<b>\$1,032,715.11</b>	<b>\$1,035,168.24</b>	<b>-0.2370%</b>
<b>Annual Cost</b>	<b>\$21,508,996.67</b>	<b>\$21,516,321.20</b>	<b>-0.0340%</b>

<sup>6</sup> Inside FERC and Gas Daily.



In seven (7) months of the audit period, amounts invoiced by Sequent and other suppliers were below the calculated benchmark for the month. In five (5) months, amounts invoiced by Sequent and other suppliers were above the calculated benchmark, but within the 2% monthly upper limit of the tariff. The total gas costs invoiced to the Company for the plan year were 0.034% below the annual benchmark amount, which is well below the plan year upper limit of 1% above the total benchmark amount. Therefore, Staff opines that Chattanooga Gas has satisfied the criteria as set forth in its tariff and should be released from the prudence audit for the plan year ended June 30, 2012.

On June 1, 2012, The Authority received Chattanooga's tariff filing<sup>7</sup> to refund the customers' share of profits accruing under the Interruptible Margin Credit Rider ("IMCR"). At March 31, 2012, the customers' share of net profits including interest and residual from the prior year totaled \$958,858.38.<sup>8</sup> Effective July 1, 2012, the Company began refunding this amount to its customers.

#### **IV. JURISDICTION OF THE TENNESSEE REGULATORY AUTHORITY**

Tennessee Code Annotated (hereafter "T.C.A.") gave jurisdiction and control over public utilities to the Tennessee Regulatory Authority. T.C.A. § 65-4-104 states:

The Authority has general supervisory and regulatory power, jurisdiction, and control over all public utilities, and also over their property, property rights, facilities, and franchises, so far as may be necessary for the purpose of carrying out the provisions of this chapter.

Further, T.C.A. § 65-4-105 grants the same power to the Authority with reference to all public utilities within its jurisdiction as chapters 3 and 5 of Title 65 of the T.C.A. has conferred on the Department of Transportation's oversight of the railroads or the Department of Safety's oversight of transportation companies. By virtue of T.C.A. § 65-3-108, said power includes the right to audit:

The department is given full power to examine the books and papers of the said companies, and to examine, under oath, the officers, agents, and employees of said companies...to procure the necessary information to intelligently and justly discharge their duties and carry out the provisions of this chapter and chapter 5 of this title.

The Authority's Utilities Division is responsible for auditing those companies under the Division's jurisdiction to insure that each company is abiding by the rules and regulations of the TRA. This audit was performed by Michelle Ramsey and Paul Greene of the Utilities Division.

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<sup>7</sup> Tariff number 2012-0205.

<sup>8</sup> The amount of the customers' share of profits accruing under the IMCR is net of \$20,000 funding for Conservation Research, \$40,230.71 for the Programmable Thermostats Program and \$70,192.21 funding for the Education and Outreach Program per the November 8, 2010 Order in Docket 09-00183. The cost of the Conservation Research is the amount in the agreement with Georgia Tech.

## **V. IPA FINDINGS**

Staff concludes there are no material findings.<sup>9</sup> Staff did note a few immaterial errors which would not affect the Company's compliance criteria as specified in its tariff.

## **VI. CONCLUSIONS AND RECOMMENDATIONS**

After reviewing the Company's gas purchases activity as reported in the ACA filing, along with the applicable benchmark indexes each month, Staff found no material errors. Staff concludes, during the plan year under review, the Company's gas purchases have met the criteria as specified in its tariff. Therefore, for the plan year ended June 30, 2012, Staff recommends that the Company be released from the prudence audit requirements encompassed in the Purchased Gas Adjustment Rule ("PGA Rule") 1220-4-7-.05.

Audit Staff recognizes and appreciates the cooperation of the Company personnel during this audit.

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<sup>9</sup> The audit goal is not to guarantee that the Company's results are 100% correct. Where it is appropriate, Staff utilizes sampling techniques to determine whether the Company's calculations are materially correct. Material discrepancies would dictate a broadening of the scope of Staff's review.

**PERFORMANCE-BASED RATEMAKING**

**APPLICABILITY**

This Performance-Based Ratemaking Mechanism (PBRM) is designed to encourage the utility to maximize its gas purchasing activities at minimum cost consistent with efficient operations and service reliability. Each plan year will begin July 1. The annual provision and filings herein will apply to this annual period. The PBRM will continue until it is either (a) terminated at the end of a plan year or by not less than 90 days notice by the Company to the Authority or (b) modified, amended or terminated by the Authority.

**OVERVIEW OF STRUCTURE**

The Performance-Based Ratemaking Mechanism establishes predefined monthly benchmark indexes to which the Company's commodity cost is compared.

**BENCHMARK INDEX**

Each month, Chattanooga Gas Company (Company / Chattanooga) will compare its actual commodity cost of gas to the appropriate benchmark amount. The benchmark gas cost will be computed by multiplying actual purchase quantities for the month, including quantities purchased for injection into storage, by the appropriate benchmark price index.

**Spot Market Purchases:**

The monthly spot market benchmark is the "Index" price published in the first issue of the delivery month of *Inside FERC's Gas Market Report* in the table titled "Price of Spot Gas Delivered to Pipelines," denoted in the column labeled "Index" and the row for the applicable "Pricing Point."

**Swing Purchases**

For swing purchases, the benchmark "Index" price for gas delivered on any day upon which *Gas Daily* is published, is equal to the Gas Daily-Midpoint price for the immediately following day under the heading "Daily Price Survey." For gas delivered on Saturday, Sunday, or any other day upon which *Gas Daily* is not published, the price index is equal to the Daily-Midpoint for the nearest subsequent day published by *Gas Daily*.

**Long-term purchases**

For long term purchases, i.e., a term more than one month, the "Index" price published in the first issue of the delivery month of *Inside FERC's Gas Market Report* in the table titled "Price of Spot Gas Delivered to Pipelines" denoted in the column labeled "Index" and the row for the applicable "Pricing Point" will be adjusted for the Company's rolling three-year average premium paid to ensure long-term supply availability during peak periods.

**City Gate Purchases**

For city gate purchases where gas is delivered by the supplier to the local distribution company, the indexes will be adjusted for the avoided transportation costs that would have been paid if the upstream capacity were purchased versus the demand charges actually paid to the supplier.

PERFORMANCE-BASED RATEMAKING (Continued)

PRUDENCE DETERMINATION

If Chattanooga's total commodity gas cost for the plan year does not exceed the total benchmark amount by one percentage point (1%) for a plan year ending after June 30, 2000, Chattanooga's gas cost will be deemed prudent and the audit required by Tennessee Regulatory Authority's Administrative Rule 1220-4-7-.05 is waived. If during any month of the plan year, the Company's commodity gas cost exceeds the benchmark amount by greater than two percentage points (2%), the Company shall file a report with the Authority fully explaining why the cost exceeded the benchmark.

FILING WITH THE AUTHORITY

The Company will file an annual report not later than 60 days following the end of each plan year identifying the actual cost of gas purchased and the applicable index for each month of the plan year.

Unless the Authority provides written notification to the Company within 180 days of such reports, the annual filing shall be deemed in compliance with the provisions of this Service Schedule.

PERIODIC INDEX REVISIONS

Because of changes in the natural gas marketplace, the price indices used by Chattanooga and the composition of Chattanooga's purchased gas portfolio may change. The Company shall, within 30 days of identifying a change to a significant component of the mechanism, provide notice of such change to the Authority. Unless the Authority provides written notice to Chattanooga within 30 days of the Company's notice to the Authority, the price indices shall be deemed approved as proposed by the Company.

AFFILIATE TRANSACTION GUIDELINES

Terms used in these affiliate transaction guidelines have the following meanings:

1. Affiliate, when used in reference to any person in this standard, means another entity who controls, is controlled by, or is under common control with, the first entity.
2. Control (including the terms "controlling", "controlled by", and "under common control with") as used in the affiliate transaction guidelines, includes, but is not limited to, the possession, directly or indirectly and whether acting alone or in conjunction with others, of the authority to direct or cause the direction of the management or policies of an entity. Under all circumstances, beneficial ownership of more than ten percent (10%) of voting securities or partnership interest of an entity shall be deemed to confer control for purposes of these affiliate transaction guidelines.
3. Gas supplier is any person who sells or otherwise provides gas to the Company. It does not include customers who transport their gas and as a result of an imbalance in the amount consumed and the amount delivered to the city gate sell gas to the Company in compliance with the Company's approved tariff provisions.

**Standards of Conduct**

The Company must conduct its business to conform to the following standards:

1. All purchases from an affiliated gas supplier of gas for system supply or storage shall be at the price and in accordance with the terms provided in a fully executed contract between the Company and the affiliated gas supplier.
2. The Company and the affiliated gas supplier shall maintain records to show that such purchases are not at a price greater than the market price at the time of the transaction.
3. All sales of gas by the Company to an affiliated gas supplier shall be in accordance with the provisions of the Company's approved tariff or at the price and in accordance with the terms provided in a fully executed contract between the Company and the affiliated gas supplier. Any sale of gas to an affiliate not in accordance with an approved tariff provision shall be at a price that is not less than the greater of the cost as recorded on the Company's books or the market price at the time of the transaction.
4. The Company shall maintain records to show that sales to an affiliated supplier are in accordance with the applicable tariff provision or, if not provided under an approved tariff provision, the price is not less than the greater of the cost as recorded on the Company's books or market price at the time of the transaction.
5. An affiliated gas supplier shall not make sales to any customer's premise that is connected to the Company's distribution facilities.
6. The Company shall not disclose to any affiliated gas supplier any information that the Company receives from a non-affiliated gas supplier that the non-affiliated gas supplier has identified as confidential unless the prior consent of the parties to which the information relates has been voluntarily given.
7. To the maximum extent practicable, the Company's operating employees and the operating employees of an affiliated gas supplier must function independently of each other.
8. The Company must maintain its books of accounts and records separately from those of an affiliated gas supplier.
9. The Company shall maintain sufficiently detailed records of all transactions with any affiliated gas supplier.

**RFP PROCEDURES FOR SELECTION OF ASSET MANAGER AND/OR GAS PROVIDER**

1. In each instance in which Chattanooga Gas Company (Company) intends to engage the services of an asset manager to provide system gas supply requirements and/or manage its assets regulated by the Tennessee Regulatory Authority (TRA), the Company shall develop a written request for proposal (RFP) defining the Company's assets to be managed and detailing the Company's minimum service requirements. The RFP shall also describe the content requirements of the bid proposals and shall include procedures for submission and evaluation of the bid proposals.
2. The RFP shall be advertised for a minimum period of thirty (30) days through a systematic notification process that includes, at a minimum, contacting potential asset managers, including past bidders and other approved asset managers, and publication in trade journals as reasonably available. This thirty (30)-day minimum period may be shortened with the written consent of the TRA Staff to a period of not less than fifteen (15) days.
3. The procedures for submission of bid proposals shall require all initial and follow-up bid proposals to be submitted in writing on or before a designated proposal deadline. The Company shall not accept initial or follow-up bid proposals that are not written, or that are submitted after the designated proposal deadline.

**PERFORMANCE-BASED RATEMAKING (Continued)**

Following receipt of initial bid proposals, and on a non-discriminatory basis, the Company may solicit follow-up bid proposals from those submitting initial bid proposals in an effort to obtain the most overall value for the transaction.

4. All initial and follow-up bid proposals shall be evaluated as they are received. The criteria for choosing the winning bid proposal shall include, at a minimum, the following: (a) the total value of the bid proposal; (b) the bidder's ability to perform the RFP requirements; (c) the bidder's asset management qualifications and experience; and (d) the bidder's financial stability and strength. The winning bid proposal shall be the one with the best combination of attributes based on the evaluation criteria. If, however, the winning bid proposal is lower in amount than any other initial or follow-up bid proposal(s), the Company shall explain in writing to the TRA why it rejected each higher bid proposal in favor of the lower winning bid proposal. The Company shall maintain records demonstrating its compliance with the evaluation and selection procedures.
5. An incumbent asset manager shall not be granted an automatic right to match a winning bid proposal. If the incumbent asset manager desires to continue its asset management relationship with the Company after expiration of its asset management agreement, it shall submit a written bid proposal in accordance with the Company's RFP procedures. The bid proposal shall be evaluated pursuant to the procedures set forth in paragraph 4 above.
6. The Company may develop additional procedures for asset management selection as it deems necessary and appropriate so long as such procedures are consistent with the agreed-upon procedures described herein.
7. The Company shall retain all RFP documents and records for at least four (4) years and such documents and records shall be subject to the review and examination of the TRA Staff. The Asset Manager shall maintain documents and records of all transaction that utilize the Company's gas supply assets. All documents and records of such transactions shall be retained for two years after termination of the agreement and shall be subject to review and examination by the Company and the TRA Staff.