

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

May 25, 2017

IN RE:

**CHATTANOOGA GAS COMPANY
ANNUAL INCENTIVE PLAN FILING FOR
THE TWELVE MONTHS ENDED JUNE 30, 2016)**

)
)
)
)
)

Docket No. 16-00098

**ORDER APPROVING COMPLIANCE AUDIT REPORT OF
TENNESSEE REGULATORY AUTHORITY'S UTILITIES DIVISION**

This matter came before Chairman David F. Jones, Vice Chairman Robin L. Morrison and Director Herbert H. Hilliard of the Tennessee Regulatory Authority ("TRA" or the "Authority"), the voting panel assigned to this docket, at a regularly scheduled Authority Conference held on March 13, 2017, for consideration of the Incentive Plan Audit ("IPA") filing for Chattanooga Gas Company ("CGC" or the "Company") for the twelve (12) months ended June 30, 2016. The Compliance Audit Report ("IPA Report" or "Report"), attached hereto as Exhibit 1, and incorporated into this document as if fully rewritten herein, contains the conclusions and recommendations of the Authority's Utilities Division Staff.

On August 26, 2016, CGC filed its report for the current plan year ended June 30, 2016. On February 13, 2017, TRA Audit Staff ("Staff") filed its IPA Report with the Authority.¹ The IPA Report describes and discusses the criteria that must be met in order for CGC to be released from the required annual audit to evaluate the prudence of any gas costs incurred that are eligible for recovery from ratepayers: (1) the total commodity gas costs incurred for the plan year must not exceed the total benchmark amount for the year by more than one percent (1%); and (2) the commodity gas costs incurred for the plan year must not exceed the monthly benchmark in any one month by more than two

¹IPA Report, Exhibit A to *Notice of Filing by the Utilities Division of the Tennessee Regulatory Authority* (February 13, 2017).

percent (2%) unless justified by the utility in a report to the TRA fully explaining why the cost exceeded the benchmark.²

To verify the monthly gas costs reported by CGC, Staff stated they reviewed all supplier invoices that were filed as part of the ACA audit³ covering the same plan year.⁴ Staff also confirmed the published national indexes used by CGC to calculate the monthly benchmark amounts. CGC's actual invoiced cost of gas was below the calculated benchmark in four of the twelve months during the period; actual invoiced cost was above the calculated benchmark but within the 2% monthly upper limit specified by the IPA Tariff for two of the twelve months during the period; and in the other remaining six months of the period, invoiced costs were above the 2% upper limit established by the IPA Tariff.

Further, CGC's total annual invoiced gas costs of approximately \$18.2 million were above the calculated annual benchmark amount of approximately \$17.6 million by 3.3%. In its IPA Report, the Staff found no material errors in the Company's calculations.⁵ However, because the actual gas costs exceeded the 1% threshold for prudence of annual gas costs established by the IPA Tariff, the Purchased Gas Adjustment ("PGA") rule requires that a prudence review of gas costs included in the PGA account be performed by a qualified consultant selected through a Request for Proposal ("RFP") process.⁶

The Company proposed, and the Staff agreed, that Exeter Associates, Inc., ("Exeter") the independent consultant currently conducting the triennial review of the Company's gas procurement activities, should be engaged to include the prudence review in the scope of the triennial review.

² *Id.* at 15.

³ *In re: Chattanooga Gas Company's ACA Filing for the Year Ending June 30, 2016*, Exhibit A, Docket No. 16-00098 (August 26, 2016).

⁴ Copies of all supplier invoices are submitted for audit in the Annual Actual Cost Adjustment (ACA) report. The ACA Audit involves reviewing all gas costs incurred during a reporting period and comparing gas costs against actual gas costs recovered from ratepayers via their monthly bills. A true up is then made for any over-or-under-recovery during this period.

⁵ IPA Report, p. 6 (February 13, 2017).

⁶ TRA Rule 1220-04-07-.05(1)(a).

On October 10, 2016, the Company filed a motion requesting that the rule requiring selection of an outside consultant through the RFP process be waived and that Exeter be allowed to expand the scope of its ongoing work to include the required prudency review for an additional fee of \$2,500 or less.⁷ On January 31, 2017, the Hearing Officer entered an order approving the motion, finding the additional costs for the expanded scope was reasonable, that Exeter was the only bidder for the current triennial review and was the winning bidder for CGC's previous triennial review, and that conducting an RFP process will likely be more costly to ratepayers than expansion of the scope of the triennial review.⁸

At a regularly scheduled Authority Conference held on March 13, 2017, the panel voted unanimously to approve and adopt the IPA Report as filed.

IT IS THEREFORE ORDERED THAT:

1. The Compliance Audit Report of Chattanooga Gas Company's Incentive Plan Account filing for the twelve (12) months ended June 30, 2016, a copy of which is attached to this Order as Exhibit 1, is approved and adopted, and is incorporated into this Order as if fully rewritten herein; and
2. The Hearing Officer's order granting Chattanooga Gas Company's motion to expand the scope of the ongoing triennial review to include the required prudency review is adopted.

Chairman David F. Jones, Vice Chairman Robin L. Morrison and Director Herbert H. Hilliard concur.

ATTEST:



Earl R. Taylor, Executive Director

⁷ *CGC's Motion to Waive Rule to Approve an Expansion of the Scope of Work With Exeter to Include a Prudency Review* (October 10, 2016).

⁸ *Order Granting Motion to Expand Consultant Scope of Work* (January 31, 2017).

EXHIBIT 1

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

February 7, 2017

IN RE:)	
)	
CHATTANOOGA GAS COMPANY)	
ANNUAL INCENTIVE PLAN FILING FOR)	Docket No. 16-00098
THE 12 MONTHS ENDED JUNE 30, 2016)	

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

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" or "IPA") 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 August 26, 2016 and the Audit Staff ("Staff") completed its audit of the same on January 30, 2017.
3. The original deadline for the completion and approval of the filing was February 22, 2017. Due to the cancellation of the Authority Conference in February, the Company and Audit Staff mutually agreed to extend the deadline for nineteen (19) days until


March 13, 2017, the date of the next regularly scheduled Authority Conference as permitted under PGA Rule 1220-4-7-.03(2).

3. Staff noted no material findings during the course of the Incentive Plan Audit.

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,


Pat Murphy, Utilities Consultant
Utilities Division of the
Tennessee Regulatory Authority

CERTIFICATE OF SERVICE

I hereby certify that on this 7th day of February 2017, 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:

David F. Jones, Chairman
Tennessee Regulatory Authority
502 Deaderick Street, 4th Floor
Nashville, TN 37243

Mr. Archie R. Hickerson
Director – Regulatory Affairs & Planning
AGL Resources, Inc.
P.O. Box 4569
Atlanta, GA 30309

Mr. Paul Leath
Director-Government and Community Affairs
AGL Resources, Inc.
2207 Olan Mills Drive
Chattanooga, TN 37201

Mr. J.W. Luna
Luna Law Group, PLLC
333 Union Street
Nashville, TN 37201

Mr. Vance Broemel
Office of the Tennessee Attorney General
Consumer Advocate and Protection Division
P.O. Box 20207
Nashville, TN 37202-0207


Pat Murphy

**COMPLIANCE AUDIT REPORT
of the
PERFORMANCE-BASED RATEMAKING TARIFF
for
CHATTANOOGA GAS COMPANY**

Docket No. 16-00098

Prepared by:

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

**February
2017**

EXHIBIT A

COMPLIANCE AUDIT REPORT
of the
PERFORMANCE-BASED RATEMAKING TARIFF

for
CHATTANOOGA GAS COMPANY
for the Year ended June 30, 2016

Docket No. 16-00098

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION AND AUDIT OPINION	1
II. BACKGROUND AND DESCRIPTION OF INCENTIVE PLAN	1
III. ACTUAL PLAN YEAR RESULTS	3
IV. JURISDICTION OF THE TENNESSEE REGULATORY AUTHORITY	5
V. IPA FINDINGS	6
VI. CONCLUSIONS AND RECOMMENDATIONS	6
ATTACHMENT 1 (PERFORMANCE-BASED RATEMAKING)	

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, 2016. After reviewing the Company's gas purchases as reported in the Actual Cost Adjustment Audit ("ACA") filing¹, along with the applicable benchmark indexes each month, Audit Staff ("Staff") found that except for the prudence issue² identified by the Company, there were no material errors in the filing. 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 No. 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, 2001.³ 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 1st, 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 (PGA) Rule.⁴ The terms under which the prudence audit will be waived are 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

¹ Docket No. 16-00099.

² The resolution of the prudence issue will be discussed later on in this report.

³ 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.

⁴ PGA Rule 1220-4-7-.05.

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."

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 Management⁵ ("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 was set to expire on March 31, 2014. On March 26, 2013, CGC filed its *Request* seeking TRA approval, pursuant to the terms of its current AMA, to extend the termination date by one year to March 31, 2015. At a regularly scheduled Authority Conference held on April 8, 2013, the panel of Directors voted to approve the CGC's *Request*.

On October 1, 2014, CGC filed its RFP for an Asset Management Agreement ("AMA") and a Gas Sales and Purchase Agreement for the TRA's approval in Docket No. 14-00101. At the October 10, 2014 Authority Conference, the panel voted to approve the RFP. On November 19, 2014, CGC filed its new AMA between the Company and Sequent for the Authority's approval in Docket No. 14-00137. On December 1, 2014, at a regularly scheduled Authority Conference, the panel voted to approve the AMA with an effective date of April 1, 2015 and a term of three years.

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.⁶ 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 No. 07-00224 to evaluate Chattanooga's gas purchases, asset management activities and related sharing mechanisms. At a regularly scheduled Authority Conference held on September 21,

⁵ Sequent is the unregulated marketing arm of AGL Resources, Inc., the parent company of Chattanooga Gas and therefore, an affiliate of Chattanooga.

⁶ Under the IMCR tariff, the utility does not share in the 50% of proceeds that are refunded to customers.

2009, the panel unanimously voted that a triennial comprehensive review of the Company's capacity planning and gas purchasing activities, as encompassed in the Incentive Plan, shall occur in the fall of 2013 with any future review determined at the conclusion of that review.

The first review process commenced in April of 2013. Exeter Associates, Inc. ("Exeter") submitted the winning bid and a contract was fully executed on September 5, 2013. On July 1, 2014, the Company filed a public redacted version of the triennial report dated June 2014, under Docket No. 07-00224. The panel in its order dated December 29, 2014 determined that future triennial reviews would benefit both the Authority and consumers and voted unanimously that the next triennial review should be commenced during the fall of 2016 and a final report issued by July 1, 2017. The Company recently completed a request for proposal for the current triennial review. The competitive bid process resulted in the awarding of a contract to Exeter Associates covering the period April 2, 2013 through March 30, 2016.

III. ACTUAL PLAN YEAR RESULTS

On August 26, 2016, Chattanooga filed an annual report as required by its tariff, showing the actual cost of gas invoiced by its affiliate asset manager Sequent and other suppliers, and the applicable benchmark index for each purchase during each month of the plan year ended June 30, 2016. Staff reviewed these supplier invoices filed as part of the Company's ACA audit, and the indexes⁷ used to calculate the benchmark each month. The table below summarizes the Company's monthly purchases as compared to the calculated monthly benchmarks.

⁷ Inside FERC and Gas Daily.

Cost of Gas			
Month	Actual Purchase Cost	Benchmark Cost	Percentage Over/(Under) Benchmark
July 2015	\$2,061,004.50	\$2,064,389.76	-0.1640%
August 2015	\$2,253,708.80	\$2,257,297.60	-0.1590%
September 2015	\$1,310,836.56	\$1,314,491.61	-0.2781%
October 2015	\$1,803,711.47	\$1,805,638.65	-0.1067%
November 2015	\$1,030,724.27	\$905,099.11	13.8797%
December 2015	\$803,474.78	\$715,849.45	12.2407%
January 2016	\$2,155,767.74	\$2,141,634.29	0.6599%
February 2016	\$1,330,538.17	\$1,306,801.65	1.8164%
March 2016	\$729,859.92	\$589,701.84	23.7676%
April 2016	\$1,694,016.98	\$1,627,044.83	4.1162%
May 2016	\$1,737,487.76	\$1,670,752.71	3.9943%
June 2016	\$1,308,792.84	\$1,244,906.69	5.1318%
Annual	\$18,219,923.79	\$17,643,608.19	3.2664%

In four (4) months of the audit period, gas supply amounts invoiced were below the calculated benchmark for the month. In two (2) months, these invoiced amounts were above the calculated benchmark, but within the 2% monthly upper limit specified by the tariff.

In the remaining six (6) months of the audit period, the invoiced amounts were above the 2% monthly upper limit of the tariff. In its cover letter to the annual filing, Chattanooga Gas explained its gas supply plan to ensure that its customers' needs are met during the coldest day of the year. According to the Company, gas purchased at the NORA receipt point in the past was obtained on a seasonal basis during the high demand heating period November through March. During the current period under review, however, the

supplier rejected the seasonal contract and required a 12-month contract. CGC explains that there is no index price for gas at the NORA receipt point, so it is necessary to compute a surrogate benchmark. In this filing CGC used Transcontinental Gas Pipeline (Transco) Zone 5, which more closely represents the price for the area, but the Company maintains additional analysis is needed to determine if it is the appropriate index or if another surrogate should be developed. These purchases contributed to the months that the actual purchases were above the calculated benchmark.

Total gas costs invoiced to the Company for the plan year were 3.2664% above the annual benchmark amount, which triggers the prudence audit requirement of gas costs found in the PGA Rule 1220-4-7-.05. The Rule requires the audit to be performed by an independent auditor obtained through a bidding process.

On June 8, 2016, the Authority received Chattanooga's tariff filing⁸ to refund the customers' share of profits accruing under the Interruptible Margin Credit Rider ("IMCR"). Effective July 1, 2016, 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 ensure that each company is abiding by the rules and regulations of the TRA. This audit was performed by Pat Murphy and Daniel Ray of the Utilities Division.

⁸ Tariff No. 2016-0092.

V. IPA FINDINGS

Staff concludes there are no material findings in the Company's calculations of the comparisons between its actual cost of gas and the appropriate benchmarks.⁹ Chattanooga provided an explanation for the six months that the actual cost of gas exceeded the 2% upper limit as required by its tariff.

As referenced under Section III, ACTUAL PLAN RESULTS, the actual gas costs for the review period ended June 30, 2016 were approximately 3.3% above the benchmark amount, which under its tariff will require an independent auditor to review the prudence of Chattanooga's gas purchasing decisions in order for the Company to recover these gas costs from customers under the Actual Cost Adjustment (ACA).¹⁰ Chattanooga discussed its proposal for the independent review with both the TRA Audit Staff and the CAPD. Both were in agreement with the proposal. On October 10, 2016, Chattanooga filed a motion¹¹ to waive the rule to allow Exeter (the current independent auditor for the triennial review) to expand its scope of work to include three extra months (April 1, 2016 -- June 30, 2016). On November 4, 2016, the Company filed supplemental information in support of its motion.¹² Exeter has agreed to expand its audit for an additional cost of no more than \$2,500. On January 31, 2017, the Hearing Officer in this docket issued her Order granting the Company's motion.¹³

VI. CONCLUSIONS AND RECOMMENDATIONS

After reviewing the Company's gas purchases activity as reported in the ACA filing¹⁴, along with the applicable benchmark indexes each month, Staff found no material errors in the Company's calculations. As shown in the schedule under Section III ACTUAL PLAN YEAR RESULTS, however, Chattanooga's gas purchases did not meet the criteria of its tariff to release the Company from the prudence audit requirements found in the PGA Rule. There were six (6) months during the review period that the amount of actual gas purchases exceeded the benchmark amount by more than 2%, requiring the Company to provide an explanation. In the cover letter for the filing, the Company detailed the reason for its purchases falling above the benchmark and provided a proposal for additional analysis to arrive at a surrogate index for NORA that would more accurately reflect the reality of the natural gas markets.

As a result of the total annual purchases amount exceeding the total annual benchmark by more than 1%, the Company's purchases must be subjected to a prudence audit by an

⁹ 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.

¹⁰ See PGA Rule 1220-4-7-.05.

¹¹ *Chattanooga Gas Company Motion to Waive Rule to Approve Expansion of the Scope of Work with Exeter to Include a Prudence Review*, October 10, 2016.

¹² *Chattanooga Gas Company Supplemental Information in Support of its Motion to Waive Rule to Approve an Expansion of the Scope of Work with Exeter to Include a Prudence Review*, November 4, 2016.

¹³ Order Granting Motion to Expand Consultant Scope of Work, January 31, 2017.

¹⁴ Docket # 16-00099.

independent auditor obtained via a RFP process in order to be considered for inclusion in the ACA Account for recovery from ratepayers. The Company proposed (and Audit Staff agreed) that the current independent auditor conducting the triennial should be engaged to include a prudency review of gas purchases for the review period in his audit. The Company filed a motion to this effect and the motion was approved by the Hearing Officer in this docket. The auditor's report will be filed in this docket and if there are any findings pertaining to the gas purchasing activities of Chattanooga during this review period, TRA Staff will address any further steps that may need to be taken at that time.

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

ATTACHMENT 1

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.