BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

DECEMBER 3, 1999

IN RE:	)	
	)	
APPLICATION OF UNITED CITIES GAS COMPANY TO ESTABLISH AN EXPERIMENTAL PERFORMANCE-BASED RATEMAKING MECHANISM	)	**DOCKET NO. 95-01134 now DOCKET NO. 97-01364**

ORDER RE: DETERMINATION OF COMPLIANCE WITH AFFILIATE GUIDELINES

This matter came before the Tennessee Regulatory Authority (the "Authority") on March 23, 1999, for consideration of the petition of United Cities Gas Company ("United Cities" or the "Company") for determination of compliance of the "Woodward Contract" with the "Tennessee Guidelines for United Cities Gas Company's Affiliate Transactions."

Background

During the regularly scheduled Authority Conference on February 16, 1999, the Authority rendered its decision on the Phase Two issues of United Cities' Application to Establish an Experimental Performance-Based Ratemaking Mechanism (hereafter "PBR").[1] In approving the permanent PBR as of April 1, 1999, the Directors determined that before any transactions between the Company and an affiliate can be included in the computation of incentive earnings, such transactions must first comply with the "Tennessee Guidelines

[1] The Authority's *Final Order On Phase Two* was entered on August 16, 1999.

for United Cities Gas Company's Affiliate Transactions" (hereafter "Affiliate Guidelines"), attached hereto as Attachment 1, as adopted by the Authority on February 16, 1999.

On March 2, 1999, United Cities Gas Company Vice President, Mark Thessin sent a copy of a letter, addressed to Authority Chairman Melvin J. Malone, to each of the three Directors of the Authority and to the Consumer Advocate requesting "guidance" from the Authority regarding a gas supply contract between United Cities and Woodward Marketing LLC, an affiliate of United Cities. On March 9, 1999, the Authority, through its General Counsel, responded to Mr. Thessin's letter by sending a letter to United Cities' counsel of record. On March 11, 1999, in response to the Authority's letter, the Company sent a letter requesting that the Authority make a "finding" that the Woodward contract complied with the requirements of Nos. 9 and 10 of the Standards of Conduct section of the Affiliate Guidelines and requested that the Authority deliberate this matter at the regularly scheduled Authority Conference on March 16, 1999. On March 11, 1999, the Company filed a formal petition that mirrored the language in its letter of March 11, 1999.

Consumer Advocate's Objections and Motion to Strike

On March 15, 1999, the Consumer Advocate Division of the Office of the Attorney General (the "Consumer Advocate") filed its Objections to United Cities Gas Letter and Filings of March 11, 1999, and to a Hearing on March 16, 1999, and Motion to Strike Ex Parte Letter. The Consumer Advocate's filing outlined four issues:

1. The Authority should not schedule these issues on the March 16, 1999, regularly scheduled Authority Conference;

2. The March 11, 1999, letter is ex parte and, therefore, should be stricken;

3. The March 11, 1999, letter asserts facts not in evidence and which have not been subject to discovery or cross examination; and

4. The March 12, 1999, petition contains facts not in evidence and which have not been the subject of discovery.

The Authority issued a Notice on March 15, 1999, to consider the Petition and the Consumer Advocate's Objections at a Special Authority Conference to be held on March 23, 1999.

In deliberating on the Consumer Advocate's objections, the Authority found that the issuance of the Authority's Notice and the Authority's consideration of the Petition at the March 23rd Special Conference rendered the Consumer Advocate's first point moot. As to the Consumer Advocate's second point, the contention of ex parte communication, Tenn. Code Ann. § 4-5-304 provides, in pertinent part, the following:

> (a) Unless required for the disposition of ex parte matters specifically authorized by statute, an administrative judge, hearing officer or agency member serving in a contested case proceeding may not communicate, directly or indirectly, regarding any issue in the proceeding, while the proceeding is pending, with any person without notice and opportunity for all parties to participate in the communication.
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> (c) Unless required for the disposition of ex parte matters specifically authorized by statute, no party to a contested case, and no other person may communicate, directly or indirectly, in connection with any issue in that proceeding, while the proceeding is pending, with any person serving as an administrative judge, hearing officer or agency member without notice and opportunity for all parties to participate in the communication.
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> (e) An administrative judge, hearing officer or agency member who receives an ex parte communication in violation of this section shall place on the record of the pending matter all written communications received, all written responses to the communications, and a memorandum stating the substance of all oral communications received, all responses made, and the identity of each person from whom the person received an ex parte communication, and shall advise all parties that these matters have

> been placed on the record. Any party desiring to rebut the ex parte communication shall be allowed to do so, upon requesting the opportunity for rebuttal within ten (10) days after notice of the communication.

Mark Thessin's letter of March 2, 1999, was served on all parties, including the Consumer Advocate. The Consumer Advocate had the opportunity to and did, in fact, respond to that letter through his letter of March 5, 1999. Both Mr. Thessin's letter and the Consumer Advocate's letter were filed in the docket file in this matter. General Counsel's letter to Mr. Thessin was served on all parties and a copy was filed in the docket file. Thereafter, James Flaherty's letter of March 11 and his filing of March 12 were both sent to the Consumer Advocate and were also filed in the docket file in this matter. Mr. Flaherty's letter could not be considered ex parte communications under Tenn. Code Ann. § 4-5-304. Furthermore, the Consumer Advocate had full opportunity to respond and did, in fact, respond to both United Cities' letter of March 11 and Petition of March 12, as evidenced by the Consumer Advocate's motion to strike filed on March 15, 1999. Therefore, the Directors concluded that neither communication from United Cities was an ex parte communication.

The Consumer Advocate contends, in issues number 3 and 4 above, that the March 11 letter and the March 12 petition assert facts not in evidence and which have not been subject to discovery or cross examination. The Consumer Advocate does not identify the facts to which he is referring. More importantly, the critical facts upon which United Cities based its current petition are in the record of the hearing and have been subjected to cross-examination or, in the least, the opportunity to cross-examine those facts was provided. The Authority does not find any support for the assertions of the Consumer Advocate and,

therefore, denies the Consumer Advocate's objections and the motion to strike filed on March 15, 1999.

United Cities' Petition

As set forth in the record of this proceeding, United Cities' original contract with Woodward expired on March 31, 1999.[2] The contract provided for an automatic renewal as of April 1, 1999, unless either party issued a notice of termination ninety (90) days prior to the renewal date. According to the Company's letter of March 2, 1999, the Company did not give notice to terminate the contract by January 1, 1999 because the Authority had not rendered its decision as to the permanency of the PBR mechanism. Therefore, the contract renewed on April 1, 1999.

The Company, in its current petition, has requested that the Authority find the Company in compliance with requirements Nos. 9 and 10 of the Standards of Conduct section of the Affiliate Guidelines.[3] Standard of Conduct No. 9 states:

> In transactions that involve either the purchase or receipt of information, assets, goods or services by the Company from an affiliated entity, the Company shall document both the fair market price of such information, assets, goods, and services and the fully distributed cost to the Company to produce the information, assets, goods or services itself.

United Cities requested clarification from the Authority that "fair market price" would be the measure against which the Company's gas purchases will be compared within the PBR.

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[2] Exhibit JDW-2 to Pre-filed Rebuttal Testimony of J.D. Woodward, (March 16 1998)

[3] These two standards were added by the Authority to the Georgia guidelines with which the Company had agreed to comply in its Post-Hearing Brief (United Cities Gas Company's Post-Hearing Brief, May 1, 1998, p. 54.) Therefore, the Company would not have been aware, at the time it renewed the Woodward contract, that these requirements would become a part of the permanent PBR.

During the hearing on United Cities' PBR, Mr. Frank Creamer, the independent consultant, in summarizing his February 2, 1996 report entitled "Review of Experimental Performance-based Ratemaking Mechanism," testified:

> We also found that the benchmark of performance was generally found to be appropriate, and they served as a proxy for the market price and set a standard against which United Cities Gas purchasing decisions would be measured against in terms of gains and losses.[4]

The Authority agreed during both phases of the PBR proceeding that the average of three (3) indices (Inside FERC, NYMEX, and Natural Gas Intelligence) would serve as a proxy for the fair market price and would be the benchmark against which United Cities' gas purchases would be compared. Therefore, the Authority concludes that the average of these three (3) indices could also be used to document the fair market price of gas purchased from an affiliated entity.

As stated above, Standard of Conduct No. 9 also requires the Company to document "the fully distributed cost to the Company to produce the information, assets, goods or services for itself." In order to prove compliance with this part of Standard of Conduct No. 9, the Company would have to provide, during the Authority Staff's audit of the Incentive Plan Account, documentation of the price the Company *would have paid* for the gas purchased from Woodward if the Company had purchased the same from an unaffiliated supplier. Such documentation would be required before the Authority could accept the Company's proprietary statement in its March 12 petition of the average price United Cities paid to non-affiliated suppliers in other states.

[4] TRA Hearing - United Cities Gas Transcript, Volume I, March 26, 1998, page 63, lines 15 though 20.

The Company also seeks clarification of Standard of Conduct No. 10 of the Affiliate Guidelines which states:

> When the Company purchases information, assets, goods or services from an affiliated entity, the Company shall either obtain competitive bids for such information, assets, goods or services or demonstrate why competitive bids were neither necessary nor appropriate.

It is the Company's position that extenuating circumstances existed which made competitive bids neither necessary nor appropriate in the renewal of the Woodward contract. Without termination notice by January 1, 1999, the Woodward contract automatically renewed on April 1, 1999. As set forth in its Petition, United Cities did not initiate a competitive bidding process because it remained satisfied that the Woodward contract provided gas at a price that was well below the market price for gas and it was unaware, prior to February 16, 1999, that competitive bids would be required by the Authority.

During the hearing on Phase Two, Consumer Advocate witness Dan McCormac acknowledged that, all other things being equal, the Woodward contract price to United Cities of eight cents ($0.08) below the basket of indices is a good deal.[5] The two consultants, Mr. Creamer and Mr. James R. Harrington, also testified that the Woodward contract provides significant benefits to the ratepayers.[6] Mr. Woodward testified that the price offered to United Cities was at least five cents ($0.05) below the price offered to any of his other customers.[7]

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[5] TRA Hearing - United Cities Gas Transcript, Volume III, March 31, 1998, page 761, lines 10 through line 13

[6] TRA Hearing - United Cities Gas Transcript, Volume II, March 27, 1998, page 446, lines 2 through line 6; page 456, line 19 through line 21; page 516, line 8 and line 9.

[7] Pre-filed Rebuttal Testimony of J.W. Woodward, (March 16, 1998) p. 8, line 12 through line 17.

Based upon the record, the Authority finds that the Woodward contract price is good, if not exceptional, and that the Woodward contract benefits Tennessee consumers, as well as United Cities. The Authority further finds that United Cities complied with Standard of Conduct No. 10 in that United Cities has demonstrated that competitive bids were neither necessary nor appropriate regarding the renewal of the Woodward contract as of April 1, 1999.

IT IS, THEREFORE, ORDERED THAT:

1. The Consumer Advocate's *Objections To United Cities Gas Letter And Filings Of March 11, 1999 And To A Hearing On March 16, 1999 And Motion To Strike Ex Parte Letter* filed on March 15, 1999 is denied.

2. United Cities will be provided the opportunity during the annual audit by the Authority Staff of the Incentive Plan Account to document the cost the Company would have paid for the gas purchased from Woodward had the Company purchased a similar amount of gas from an unaffiliated supplier.

3. The Authority's finding of compliance with Standard of Conduct No. 10 is based on the existence of exceptional circumstances and does not establish a precedent. This initial finding by the Authority of the Company's compliance with Standard of Conduct No. 10 for year one of the permanent PBR plan is not a determination of compliance with the other Affiliate Guidelines.

4. On a going-forward basis, Standard of Conduct No. 10 will be in effect and United Cities must provide proof of competitive bids before a contract with an affiliate will be included in the PBR computation.

5. United Cities will maintain complete documentation of its compliance with all of the Affiliate Guidelines. This documentation will be presented to the Authority's Staff during the annual audit of the Incentive Plan Account for the Staff to determine at the conclusion of the audit whether the Company has sufficiently complied with all of the Affiliate Guidelines.

5. Any party aggrieved by the Authority's decision in this matter may file a Petition for Reconsideration with the Authority within ten (10) days from the date of this Order.

Melvin J. Malone, Chairman

H. Lynn Greer, Jr., Director

Sara Kyle, Director

ATTEST:

K. David Waddell, Executive Secretary

ATTACHMENT I

TENNESSEE GUIDELINES FOR UNITED CITIES GAS COMPANY'S AFFILIATE TRANSACTIONS

The following guidelines present the minimum conditions deemed necessary to ensure that affiliate transactions between United Cities Gas Company (hereafter "United Cities" or "Company") and its affiliate(s) do not result in a competitive advantage over others providing similar services. The effective date of these guidelines is April 1, 1999, and said guidelines will remain in effect as long as United Cities is operating under a performance based ratemaking plan. We note that these guidelines may fail to anticipate certain specific methods by which such advantages may be conferred by the Company on its marketing affiliates. All parties should be aware that to the extent such instances arise in the future, they will be judged according to this stated intent. This Agreement has three parts: Definitions, Standard of Conduct and Complaint procedures.

Definitions

Terms used in these guidelines have the following meanings:

1. Affiliate, when used in reference to any person in this standard, means another person who controls, is controlled by, or is under common control with, the first person.

2. Control (including the terms "controlling", "controlled by", and "under common control with"), as used in this standard, 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 a company. 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 guidelines of conduct.

3. Marketing, as used in this standard, means selling or brokering natural gas to any person or entity, including the Company, by a seller that is not a local distribution company.

Standards of Conduct

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

1. If there is discretion in the application of tariff provisions, then the Company must apply such provisions relating to any service being offered in a consistent manner to all similarly situated entities.

2. The Company must strictly enforce a tariff provision for which there is no discretion in the application of the provision.

3. The Company must process all similar requests for services in the same manner and within the same period of time.

4. The Company may not give its marketing affiliate preference over nonaffiliated companies in natural gas supply procurement activities.

5. The Company may not give its marketing affiliate preference over nonaffiliated companies in its upstream capacity release activities.

6. The Company may not disclose to its marketing affiliate any information that the local distribution company receives from a non-affiliated marketer, unless the prior written consent of the parties to which the information relates has been voluntarily given.

7. To the extent the Company provides information related to its natural gas supply activities and upstream capacity release activities, it must do so contemporaneously to all nonaffiliated marketers, that have submitted a written request for such information to the Company.

8. To the extent the Company provides information related to natural gas services being offered to a marketing affiliate, it must do so contemporaneously to all non-affiliated marketers, that have submitted a written request for such information to the Company.

9. In transactions that involve either the purchase or receipt of information, assets, goods or services by the Company from an affiliated entity, the Company shall document both the fair market price of such information, assets, goods, and services and the fully distributed cost to the Company to produce the information, assets, goods or services for itself.

10. When the Company purchases information, assets, goods or services from an affiliated entity, the Company shall either obtain competitive bids for such information, assets, goods or services or demonstrate why competitive bids were neither necessary nor appropriate.

11. To the maximum extent practicable, the Company's operating employees and the operating employees of its marketing affiliate must function independently of each other. For the purposes of these guidelines, operating employees are those who are in any way involved in identifying and contracting with customers, locating gas supplies, making any and all arrangements with intervening pipelines and in any way managing or facilitating those contracted services.

12. The Company must maintain its books of accounts and records separately from those of its affiliate.

13. If the Company offers a discount to an affiliated marketer, it must make a comparable offer contemporaneously available to all similarly situated non-affiliated marketers.

14. The Company may not condition or tie its agreement to release its dedicated, stored, inventoried or optioned gas or supply contracts or upstream transportation and storage contracts to an agreement with a producer, customer, end-user or shipper relating to any service by its marketing affiliate, any services offered by the Company on behalf of its marketing affiliate, or any services in which its marketing affiliate is involved.

15. Prearranged, non-posted, capacity release transactions may not be entered into with any affiliate of the Company in any two consecutive thirty-day periods.

16. The Company must maintain a written log of tariff provision waivers which it grants. It must provide the log to any person requesting it within 24 hours of request. Any waivers must be granted in the same manner to the same or similar situated persons.

17. The Company shall maintain sufficiently detailed records that compliance with these guidelines can be verified at any time.

Complaints

Any party may file a complaint relating to violations of these guidelines.

1. Any customer, marketer, or other interested third-party may file a complaint with the Tennessee Regulatory Authority ("TRA" or "Authority") relating to alleged violations of the affiliate standards set forth in these guidelines. At or before the time of filing, the complainant shall serve a copy of the complaint on the Company.

2. Within ten (10) days of service of the complaint upon the Company, the Company shall file a written response to the complaint with the TRA.

3. The TRA may hold hearings on any complaint filed or may take such other action (as it may deem appropriate), including requesting further information from the parties or dismissing the complaint.

4. After notice and opportunity for a hearing, should the Authority find that the Company has violated the standards contained in these guidelines, the TRA may impose any penalty or remedy provided for by law.