

**BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE**

JULY 29, 1999

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| IN RE: |) | |
| COUNCE NATURAL GAS COMPANY |) | DOCKET NO.: 99-00003 |
| ACTUAL COST ADJUSTMENT (ACA) AUDIT |) | |

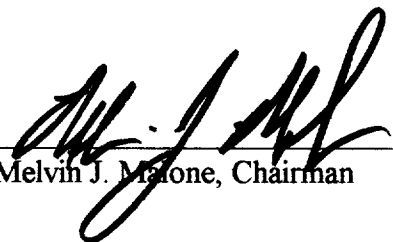
ORDER ADOPTING ACA AUDIT REPORT OF AUTHORITY'S STAFF

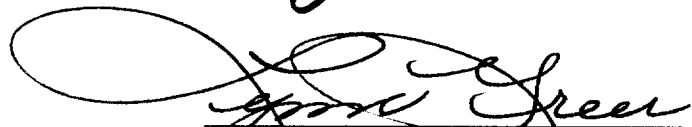
This matter came before the Tennessee Regulatory Authority (hereafter the "Authority") at a regularly scheduled Authority Conference held on April 20, 1999, for consideration of the report of the Authority's Energy and Water Division (hereafter the "Staff") resulting from the Staff's audit of Counce Natural Gas Company's (hereafter "Counce" or the "Company") annual deferred gas cost account for the year ended through September 30, 1998. The ACA Audit Report (hereafter the "Report"), attached hereto as Exhibit A, contains the audit findings of the Authority's Staff, the responses thereto of Counce, and the recommendations of the Staff in addressing its findings. As stated in the Report, the Company agreed with each of the Staff's findings. The Staff's audit revealed that the balance in the deferred gas cost account as of September 30, 1998, is a net over-recovery of \$19,662.86.

After consideration of the ACA Audit Report, the Authority unanimously approved and adopted the findings and recommendations contained therein.

IT IS THEREFORE ORDERED THAT:

1. The ACA Audit Report is approved and adopted, including the findings and recommendations contained therein; and
2. 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.

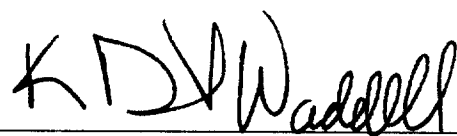


Melvin J. Malone, Chairman

H. Lynn Greer, Jr., Director

Sara Kyle, Director

ATTEST:



K. David Waddell, Executive Secretary

COMPLIANCE AUDIT REPORT

OF

COUNCE NATURAL GAS COMPANY

ACTUAL COST ADJUSTMENT

DOCKET #99-00003

PREPARED BY THE

TENNESSEE REGULATORY AUTHORITY

ENERGY AND WATER DIVISION

March, 1999

EXHIBIT A

COMPLIANCE AUDIT
COUNCE NATURAL GAS COMPANY
ACTUAL COST ADJUSTMENT
DOCKET #99-00003

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I. JURISDICTION AND POWER OF THE TENNESSEE REGULATORY AUTHORITY

Tennessee Code Annotated (T.C.A.) §65-4-104 gave jurisdiction and control over public utilities to the Tennessee Public Service Commission. By virtue of Chapter 305 of the Public Acts of 1995, jurisdiction and control over public utilities were transferred from the Tennessee Public Service Commission (TPSC or Commission) to the Tennessee Regulatory Authority (the “TRA” or “Authority”) on July 01, 1996. T.C.A. §65-4-104 states that:

The Authority shall have general supervision and regulation of, jurisdiction, and control over, all public utilities...

T.C.A. §65-4-111 gives the TRA the power to require public utilities to maintain a Uniform System of Accounts. T.C.A. §65-4-111 states that:

The Authority shall have the power after hearing, upon notice, by order in writing to require every public utility... to keep its books, records, and accounts so as to afford an intelligent understanding of the conduct of its business, and to that end to require every public utility of the same class to adopt a uniform system of accounting. Such system shall conform, where applicable, to any system adopted or approved by the Interstate Commerce Commission of the United States. And to furnish annually, or at other times as the authority may require, a detailed report of finances and operations as shown by said system of accounts.

The TRA responded to T.C.A. §65-4-111 by establishing Rule 1220-4-1-1.11 regarding the uniform system of accounts which public utilities should maintain. The TRA’s rule provides that all utilities follow the Uniform System of Accounts as adopted and amended by the National Association of Regulatory Utility Commissioners (NARUC).

The TRA received its authority to examine the books and records of public utilities from T.C.A. §65-3-108 which states that the TRA shall possess:

...full power to examine the books and papers of the companies, and to examine, under oath, the officers, agents, and employees of the companies and any other persons, to procure the necessary information to intelligently and justly discharge its duties and carry out the provisions of this chapter and chapter 5 of this title.

II. PURPOSE OF COMPLIANCE AUDITS

The two basic reasons for compliance audits are to assure compliance with the Uniform System of Accounts (USOA) and to assure that the utility is following all rules, regulations and directives adopted by the TRA.

Compliance audits provide the foundation of assurance underlying the basic objective of regulatory accounting, which is to provide a uniform method of recording transactions among similar companies. This uniform record keeping is accomplished through the adoption of the USOA and insures the integrity, reliability, and comparability of the financial data contained in financial reports filed with the TRA which provides the TRA one of its most useful regulatory tools for establishing just and reasonable rates.

III. DESCRIPTION OF PURCHASED GAS ADJUSTMENT (PGA) RULE

The Tennessee Regulatory Authority issued an Order in Docket No. G-86-1, which adopted a new PGA rule beginning July 1, 1992. The PGA Rider is intended to permit the Company to recover, in a timely fashion, the total cost of gas purchased for delivery to its customers and to assure that the Company does not over-collect or under-collect gas costs from its customers. This PGA consists of three major components:

- 1) The Actual Cost Adjustment (ACA)
- 2) The Gas Charge Adjustment (GCA)
- 3) The Refund Adjustment (RA)

The ACA is the difference between the revenues billed customers by means of the GCA and the cost of gas invoiced the Company by suppliers plus margin loss (if allowed by order of the TRA in another docket) as reflected in the Deferred Gas Cost account. The ACA then "true-up" the difference between the actual gas costs and the gas costs recovered from the customer through a surcharge or a refund. The RA refunds the "true-up" along with other supplier refunds.

IV. AUDIT TEAM

The TRA's Energy and Water Division is responsible for conducting compliance audits of gas, water, and electric utilities. This audit was conducted by Pat Murphy of the Energy and Water Division.

V. OBJECTIVE AND SCOPE OF AUDIT

The order for Docket G-86-1 required that the Company

each year...shall file with the Authority an annual report reflecting the transactions in the Deferred Gas Cost Account. Unless the Authority provides written notification to the Company within one hundred eighty (180) days from the date of filing the report, the Deferred Gas Cost Adjustment Account shall be deemed in compliance with the provisions of this Rule...

The objective of this audit was to determine that Purchased Gas Adjustments, which are encompassed by the ACA and were described above, approved by the TRA during the period from October 1, 1997 to September 30, 1998, had been calculated correctly and were supported by appropriate source documentation. To accomplish this task, the Staff conducted in-house audit work during which the Company's gas supplier invoices were examined and calculations of gas costs recovered were made.

The Staff also audited a sample of customer bills to determine if the proper PGA rates were being applied in the Company's calculation of the customers' bills. These bills were selected to be representative of the residential, commercial and industrial customers. The sample was selected from all twelve months of the audit period.

The Staff's last ACA audit of Counce Natural Gas was conducted in 1998 and covered the period February 1, 1996 through September 30, 1997.

VI. COMPANY BACKGROUND

Counce Natural Gas Company (Counce), with its headquarters in West Point, MS, is a wholly owned subsidiary of Tumlinson Engineering, Inc., and was formed in 1995 for the purpose of acquiring the operating authority of Hardin County Gas Company and providing natural gas service to customers in Hardin County, Tennessee. Hardin County Gas Company's certificate of convenience and necessity (CCN) was transferred to Counce on December 22, 1995, per Docket #95-03379. The natural gas used to serve this area is purchased from Midcoast Marketing, Inc. The gas purchases are made in accordance with separate and individual tariffs approved by the Federal Energy Regulatory Commission, while the gas transported is purchased under contract or on the spot market.

VII. ACA FINDINGS

Since Counce is a small Company without benefit of an accounting staff, it did not make an official ACA filing. By letter dated December 2, 1998, the Staff requested that the Company supply information detailing its gas purchases and gas sales for the period October 1, 1997 through September 30, 1998, to enable the Staff to calculate gas costs incurred and gas costs recovered from its customers. On December 9, 1998, the Company responded to the request. The Staff's audit results show an **over-collection** of gas costs during the ACA period of **\$19,662.86**.

SUMMARY:

| | | | |
|------------|---------------------------|---------------------------|------------------------|
| FINDING #1 | Incorrect PGA Adjustments | \$18,677.62 | Over-collection |
| FINDING #2 | Interest Adjustment | <u>985.24</u> | Over-collection |
| | NET RESULT | <u>\$19,662.86</u> | Over-collection |

FINDING #1

Exception

*The Company has continued to charge incorrect PGA rates in billing its customers, resulting in an **over-collection** of gas costs in the amount of **\$18,677.62**.*

Discussion

In its findings associated with the last ACA audit of the Company (relevant portion of audit report dated March 13, 1998, is attached as Attachment 3), the Staff reported that the purchased gas adjustments used by the Company were incorrect. Upon acquiring the certificate of convenience and necessity (CCN) formerly held by Hardin County Gas Company (Docket No. 95-03379), Counce continued to charge the same purchased gas adjustment that was in effect for Hardin County, when in fact Counce's cost of gas was less than Hardin County's cost of gas at that time. Subsequently, Counce passed on to its customers a gas cost increase which occurred on October 1, 1996, without filing a PGA with the TRA. Instead of recalculating the correct purchased gas adjustment, the increase was added to the purchased gas adjustment already being charged. The overcollection of gas costs which resulted was substantial.

At the time the last audit was being conducted, Counce had passed on another gas cost increase, effective October 1, 1997. This increase affected customer bills outside the period being audited. However, Counce was notified by letter dated December 23, 1997, that in order to comply with the TRA Rules and Regulations, it must file a PGA immediately to adjust its gas cost recovery. Counce did so, and the Staff notified the Company by letter dated January 9, 1998 that the correct purchased gas adjustment to charge beginning with the January customer billing was \$2.5266.

Results of this audit reveal that Counce did not place the above purchased gas adjustment into effect in January, 1998. The Company continued to bill its customers the adjustment that was being billed in October, 1997 (\$4.6927) through the April, 1998 billing. For unknown reasons, this adjustment was decreased in May, 1998 by \$.65 and in June, 1998 by another \$.12.

On May 4, 1998, Counce filed a petition for an increase in its rates to produce an increase in annual revenue of \$20,913. The Company and the Staff reached a settlement agreement allowing the increase requested by Counce. This agreement stated that the appropriate base rate to produce the increase in revenue was **\$2.1304**. The settlement agreement was approved by the Directors at their July 21, 1998 TRA Conference. At that time, new tariffs were requested from the Company and the billing rate should have been \$2.1304 plus the appropriate purchased gas adjustment.

However, in August, 1998, Counce placed into effect the rate that had been calculated in its rate petition (**\$8.16**). That rate was incorrectly calculated, in that it did not take into account the revenue produced by the minimum monthly charges and did not apply to all customer classes as stipulated in the settlement agreement. Also, the rate considered in the rate petition applies only to the Company's margin and does not include gas costs. The rate calculated by the Company **exceeds** the total billing rate authorized for Counce pursuant to the Directors' decision on July 21, 1998. Counce has continued to charge this incorrect rate through its February, 1999 billing, despite the fact that it filed a PGA, effective November 1, 1998, to reflect a decrease in its cost of gas.

The result of the Company's use of incorrect PGA rates to recover its gas costs during this entire twelve (12) month period is that it has **over-collected gas costs** from its customers in the amount of **\$18,677.62**. The over-collection was mitigated by the fact that Counce continued a refund that was begun pursuant to the Order transferring the CCN from Hardin County to Counce, which could have been discontinued earlier. (See Attachment 2)

Company Response

The Company accepts the findings.

FINDING #2

Exception

*Based on Finding #1, the Company has **over-collected** additional gas costs of **\$985.24** in monthly interest due customers.*

Discussion

The Purchased Gas Adjustment Rule states that the balance in the ACA account “shall be adjusted for interest at the rate provided for the calculation of interest with respect to the Refund Adjustment”. Those interest rates are determined by the TRA on a quarterly basis. Applying the interest rates to the monthly balances referred to in Finding #1 produces interest due customers in the amount of \$985.24. (See Attachment 1)

Company Response

The Company accepts the findings.

VIII. CONCLUSIONS AND RECOMMENDATIONS

History

The regulatory course for this company has been a bumpy one. Counce acquired the certificate of convenience and necessity (CCN) from Hardin County Gas Company pursuant to the order in Docket 95-03379, and was to continue the rates in effect for Hardin County. In addition, results of the final ACA audit conducted for Hardin County through January 31, 1996 showed refunds due customers for over-collected gas costs of \$34,703. Hardin remitted this amount to Counce to be flowed back to the customers in a manner consistent with the Tennessee Public Service Commission guidelines.

At the time of the Staff's initial ACA audit of Counce, it became apparent that the Company did not understand the concept of base rates and the purchased gas adjustment. Inadvertently, the Company continued the rates charged by Hardin, which included a purchased gas adjustment greater than Counce's cost of gas, and passed on gas cost increases in addition to those rates. The over-collection of gas costs that resulted and which were discovered during the Staff's audit were significant (\$69,456). The Staff realized that the actions of the Company were not intentional and that refunding the over-collection during the customary 12 month period would create undue hardship on the Company. Therefore, the Staff recommended in its March 13, 1998 audit report that the refund take place over a three year period, beginning June 20, 1998.

The Company's counsel, Mr. Henry Walker, filed a response to the Staff's audit report on March 20, 1998. In summary, he stated that the Company did not overcharge its customers in total, but that it inappropriately used the revenues collected via the purchased gas adjustment to cover its operating expenses. The Company should have come to the TRA to request an increase in base rates, but failed to do so. During the March 24, 1998 Directors' Conference, Mr. Walker stated that Counce was prepared to file a rate increase petition by May 1, 1998 and asked the Directors to delay making a decision on the purchased gas refund until a decision on the rate case had been made. The Directors unanimously voted to accept the Staff's audit report and to require the refund with accrued interest to begin August 20 over a three year period, subject to any modifications that the Authority deemed necessary.

On May 4, 1998, the Company filed a petition with the Authority requesting a revenue increase of \$20,913. At the July 21, 1998 Directors' Conference, the Directors unanimously approved the settlement agreement between the TRA Staff and the Company approving the requested increase. The rate needed to produce this increase was stipulated to be \$2.1304.

There remained a question of the Company's obligation to refund the \$69,456 plus additional accrued interest over a three year period. The Company requested a hearing on the matter. After some negotiations between the TRA Staff and the Company, a settlement agreement was reached, whereby Counce would not be required to refund the

\$69,456 plus additional accrued interest of \$6,139, on the condition that Counce not seek an additional rate increase for three years. This settlement agreement was approved by the Directors at their February 2, 1999 Conference.

Conclusions and Recommendations

During this audit period, the PGA mechanism has not worked properly. The Staff has tried to work with Mr. Tumlinson to make sure the correct rates were in effect. However, this past year since the last audit has evidently still produced some confusion. The refund of the over-collection of gas costs was placed on hold, a rate case was filed, and eventually the obligation of the Company to make the refund was canceled (after the close of the current audit period). After speaking with Mr. Tumlinson, the Staff is of the opinion that he thought he was placing into effect the approved rate increase in August, 1998, when he began charging \$8.16. That was the rate that had been calculated by his accountant in the rate petition. As pointed out in Finding #1 above, this rate did not accurately reflect the requested revenue increase. The correct rate was recalculated by the Staff and stated in the settlement agreement which resulted between the Staff and the Company. When the Company filed its revised tariff with the TRA, it stated the correct rate.

In order to refund the over-collection of \$19,662.86 over a 12 month period, the Staff has calculated the refund adjustment to be **-\$1.242** per MCF. (See Attachment 2) The Staff has notified Mr. Tumlinson by letter dated March 12, 1999 that the correct billing rate for its customers beginning with the March, 1999 billing is **\$4.37** per MCF. The rate is made up of the \$2.13 base rate plus the \$3.48 approved purchased gas adjustment plus the **-\$1.24** refund adjustment. In order to assure that Mr. Tumlinson understands the current approved rate, Staff requested that the rate change be made to his billing system and proof be submitted to Staff that the change was made. Mr. Tumlinson complied with the request and Staff received a printout of his rate tables on March 24, 1999.

Therefore, Staff concludes that the ongoing error in rates has been corrected. As a follow-up, Staff will request copies of some customer bills in April to confirm that the correct rates are being charged. A residual effect of incorrect rates will be found in the next ACA audit, which covers the period October 1, 1998 to September 30, 1999, due to the overlap of time. It is hoped that in the next audit the Staff will be able to report the PGA mechanism is working properly and in accordance with the Authority's rules and regulations.