BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

JUNE 29, 2000

IN RE:	)	
	)	
AUDIT OF CHATTANOOGA GAS COMPANY AND MOTION OF CHATTANOOGA GAS COMPANY FOR RELEASE FROM PROBATION	)	DOCKET NO. 99-00759
	)	

ORDER APPROVING AND ADOPTING COMPLIANCE AUDIT REPORT

On March 28, 2000, this matter came before the Tennessee Regulatory Authority ("Authority") for consideration of the Authority Staff's March 13, 2000 Compliance Audit Report concerning Chattanooga Gas Company ("Chattanooga") and of Chattanooga's motion for release from the one-year probation under which it was placed by the Authority at the June 8, 1999 Authority Conference.

Background

The Purchased Gas Adjustment Rule, contained in Chapter 1220—4—7 of the Rules of the Tennessee Regulatory Authority, permits a gas utility company to recover the total cost of gas purchased for delivery to its customers and is intended to assure that the company does not over-collect or under-collect from its customers. A major component of this rule is the Actual Cost Adjustment ("ACA"), on the basis of which the company is permitted to "true up," through a surcharge or refund, the difference between its actual gas costs and the gas costs recovered from its customers. Rule 1220—4—7.03(2) requires a company to file an ACA report with the Authority every year.

Chattanooga is a gas utility company which serves customers in Chattanooga and Cleveland, Tennessee and surrounding areas in Hamilton and Bradley Counties. Chattanooga submitted its annual ACA filing to the Authority on October 5, 1998. Chattanooga's ACA filing reflected a net under-collection of gas costs from customers for the year ended June 30, 1998 of $2,985,682. A review by the Authority Staff of Chattanooga's filing, filed in Docket No. 98-00766, revised the under-collection figure to $1,178,686. The Staff concluded, in an audit report submitted to the Authority on May 13, 1999, that Chattanooga's procedures for accounting for its gas purchases and recoveries were deficient and that Chattanooga had failed to comply with the ACA component of the Purchased Gas Adjustment Rule.

The June 8, 1999 Conference

At the regularly scheduled Authority Conference held on June 8, 1999, the Directors approved and adopted the Authority Staff's May 13, 1999 audit report in Docket No. 98-00776. The Authority also placed Chattanooga on probation for a period of one (1) year from and after the date of the entry of the order reflecting the Directors' decision. The Authority required Chattanooga to have corrected all deficiencies cited in the Staff's May 13, 1999 audit report at the conclusion of the probationary period in order to avoid further corrective action and possible sanctions by the Authority. The Order reflecting these decisions was entered on June 22, 1999. A copy of this Order is attached hereto as Exhibit A.

Chattanooga's 1999 ACA Filing

On October 4, 1999, the Authority Staff received Chattanooga's ACA filing for the period from July 1, 1998 through June 30, 1999. The present docket was opened to hear matters arising out of the Staff's audit of this filing. The Staff completed its preliminary audit of Chattanooga's filing on March 3, 2000 and sent its findings to Chattanooga on March 7, 2000. Chattanooga responded on March 10, 2000. The Staff modified its preliminary audit report and submitted its final Compliance Audit Report (the "Report") to the Authority on March 13, 2000. The Report states, among other things, that Chattanooga has taken the necessary steps to correct the deficiencies cited in the May 13, 1999 audit. A copy of the Report is attached hereto as Exhibit B.

Chattanooga's Motion

On March 20, 2000, Chattanooga filed with the Authority a Motion for Release from Probation (the "Motion") in both this docket and in Docket No. 98-00766. In support of its Motion, Chattanooga cited several steps it had taken to address its problems. Chattanooga also cited the favorable findings in the Authority Staff's March 13, 2000 Report. Chattanooga argued that the Authority's purpose in placing it on probation has now been achieved and that Chattanooga's behavior has been intentionally modified. Therefore, Chattanooga argued, the probation should be ended.

The March 28, 2000 Conference

This matter came before the Authority at the regularly scheduled Authority Conference held on March 28, 2000. By unanimous vote, the Directors approved and adopted the Report. However, Chattanooga's Motion was not granted.[1] Therefore, the probation shall remain in effect until the expiration of the one-year period or until June 22, 2000.

[1] Director Kyle's motion to release Chattanooga from probation did not pass.

IT IS THEREFORE ORDERED THAT:

1. The Authority Staff's March 13, 2000 Compliance Audit Report, attached hereto as Exhibit B, is approved and adopted, and is incorporated in this Order as if fully rewritten herein;

2. The probationary period for Chattanooga Gas Company shall continue in effect as set forth in the Authority's Order entered on June 22, 1999 in Docket No. 98-00776, attached hereto as Exhibit A; and

3. Any party aggrieved by the Authority's decision in this matter may file a Petition for Reconsideration with the Authority within fifteen (15) days from the date of this Order.

Melvin J. Malone, Chairman

H. Lynn Greer, Jr., Director

mc

Sara Kyle, Director

ATTEST:

K. David Waddell, Executive Secretary

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

JUNE 22, 1999

IN RE:	)	
	)	
CHATTANOOGA GAS COMPANY ACTUAL COST ADJUSTMENT (ACA) AUDIT	))	DOCKET NO. 98-00776
	)	
	)	

ORDER ADOPTING ACA AUDIT REPORT OF AUTHORITY STAFF

This matter came before the Tennessee Regulatory Authority ("Authority") at a regularly scheduled Authority Conference held on June 8, 1999, for consideration of the audit findings of the Authority's Energy and Water Division (the "Authority Staff") after review of Chattanooga Gas Company's ("Chattanooga Gas" or the "Company") annual deferred gas cost account filing for the period July 1, 1997, through June 30, 1998. The findings of the Authority Staff are contained in the Actual Cost Adjustment (hereafter "ACA") Audit Report attached hereto as Exhibit A.

The ACA Audit Report contains the audit findings of the Authority Staff, the responses thereto of Chattanooga Gas, and the recommendations of the Authority Staff in addressing its findings. The Company's Actual Cost Adjustment filing dated October 5, 1997, reflected a net under-collection of gas costs from ratepayers for the year ended June 30, 1998, of $2,985,682. The net effect of the Authority Staff's audit findings reduces the Company's under-collection by $1,806,996 to $1,178,686. The serious accounting deficiencies noted in the Audit Report and the materiality of the dollar findings resulted in the Authority Staff issuing an adverse opinion.

EXHIBIT A

After consideration of the ACA Audit Report and after hearing comments from a representative of Chattanooga Gas who did not refute or oppose the findings in the Audit Report, the Authority unanimously approved the Audit Report and adopted the findings and recommendations contained therein. Further, Chattanooga Gas' representative agreed to submit to the Authority, within thirty (30) days from the entry of this Order, a summary of the steps taken by the Company to correct the deficiencies in its accounting procedures. In approving the ACA Audit Report, the Authority expressed concern over the serious deficiencies noted by the Authority Staff and unanimously decided to place the Company on probation for a period of one (1) year. The Company was duly advised that at the conclusion of the probationary period, the Company must have corrected all of the deficiencies cited in the Audit Report in order to avoid further corrective action and possible sanctions by the Authority.

IT IS THEREFORE ORDERED THAT:

1. The ACA Audit Report, attached hereto as Exhibit A, is approved and adopted, and is fully incorporated in this Order as if restated verbatim herein.

2. As a result of the serious accounting deficiencies noted in the ACA Audit Report and the materiality of the dollar findings contained therein, Chattanooga Gas Company is hereby placed on probation for a period of one (1) year from and after the date of the entry of this Order. At the conclusion of this probationary period, the Company shall have corrected all deficiencies cited in the Audit Report in order to avoid further corrective action and possible sanctions by the Authority.

3. Chattanooga Gas shall submit within thirty (30) days from the entry of this Order, a summary of the steps taken by the Company to correct the deficiencies in its accounting procedures.

4. 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 the
ACTUAL COST ADJUSTMENT COMPONENT
of the
PURCHASED GAS ADJUSTMENT RULE
for
CHATTANOOGA GAS COMPANY

Docket No. 99-00759

Prepared by:

THE ENERGY AND WATER DIVISION
of the
TENNESSEE REGULATORY AUTHORITY

MARCH 2000

EXHIBIT B

COMPLIANCE AUDIT REPORT
of the
ACTUAL COST ADJUSTMENT COMPONENT
of the
PURCHASED GAS ADJUSTMENT RULE
for
CHATTANOOGA GAS COMPANY
for the Year ended June 30, 1999

Docket No. 99-00759

TABLE OF CONTENTS

I. INTRODUCTION

The subject of this audit is Chattanooga Gas Company's (hereafter the "Company" or "Chattanooga Gas") compliance with the Actual Cost Adjustment and Refund Adjustment of the Purchased Gas Adjustment Rule (hereafter "PGA") of the Tennessee Regulatory Authority (hereafter the "TRA" or the "Authority"). The objective of the audit was to determine whether the Purchased Gas Adjustments, which are encompassed by the Actual Cost Adjustment (hereafter "ACA") as more fully described in section V., for the year ended June 30, 1999, were calculated correctly and were supported by appropriate source documentation. Also, because of the adverse opinion that resulted from the last audit, Staff will address the steps the Company has taken to correct the weaknesses reported.

II. AUDIT OPINION

The Staff's last audit of Chattanooga's Deferred Gas Cost account for the ACA period July 1, 1997 through June 30, 1998 resulted in fifty-five (55) exceptions, the net effect of which reduced the balance in the account by $1,806,996. The materiality of the findings and seriousness of the accounting deficiencies were such that Staff concluded the Company had failed to comply with the Actual Cost Adjustment component of the Purchased Gas Adjustment Rule. This adverse audit opinion resulted in the Company being placed on probation for a period of one year.[1]

The June 22, 1999 Authority Order required the Company to submit a summary of the steps taken by the Company to correct the deficiencies in its accounting procedures. The Company responded by letter dated July 6, 1999. In summary, those steps included: (1) contracting with an independent CPA firm to review future ACA filings before they are submitted to the TRA, (2) devoting two individuals full time to ensure that Tennessee operations are properly accounted for, and (3) conducting regular meetings with the TRA Staff. The independent accounting firm of Work & Greer, P.C. reviewed the Company's Actual Cost Adjustment ("ACA") filing for the audit period July 1, 1998 through June 30, 1999, and a copy of the Independent Accountant's Report ("Accountant's Report")[2] was provided to the Staff. Staff reviewed this report as part of its auditing process. Staff also looked at other concerns enumerated in last year's report to see if the Company had made the necessary corrections. The results of this review are detailed in Section VI.[3] Staff has had several meetings with the individuals responsible for the Tennessee operations and an on going dialog with the Company during the current audit has made the audit process much smoother.

The audit findings for the current ACA period are detailed in Section VII. The results of the audit increased the net underrecovery of $806,571.66 by $68,700.16. **The corrected net balance in the Deferred Gas Cost account should be $875,271.82**. Staff agrees that the Company has taken the necessary steps to correct the deficiencies cited in the last audit. The

---

1 The June 22, 1999 Authority Order is attached to this report as Exhibit B.
2 The Accountant's Report is attached as Exhibit C.
3 The Staff's audit report submitted May 13, 1999 is attached (in part) as Exhibit D.

Company has also advised Staff that they intend to retain the services of the independent CPA firm to review their ACA filing for one more year to assure that the necessary internal accounting controls and procedures are in place. Therefore, Staff concludes that for the current ACA filing period the Purchased Gas Adjustment mechanism as calculated in the Actual Cost Adjustment is working properly and in accordance with the TRA's rules.

III. BACKGROUND INFORMATION ON COMPANY

Chattanooga Gas Company, located at 6125 Preservation Drive in Chattanooga, Tennessee, is a wholly owned subsidiary of Atlanta Gas Light Company, which has its main office at 1251 Caroline St. N.E., Atlanta, Georgia. As a local distribution company (hereafter "LDC") Chattanooga Gas provides service to customers in Chattanooga and Cleveland, Tennessee, and environs in Hamilton and Bradley Counties in Tennessee, respectively. The natural gas used to serve these areas is purchased from three natural gas pipelines in accordance with separate and individual tariffs approved by the Federal Energy Regulatory Commission. The three interstate pipelines are Tennessee Gas Pipeline, East Tennessee Natural Gas, and Southern Natural Gas.

IV. JURISDICTION OF THE TENNESSEE REGULATORY AUTHORITY

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

> The Authority shall have 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 Energy and Water Division of the TRA is responsible for auditing those companies under the Division's jurisdiction to ensure that each company is abiding by Tennessee statute as well as the Rules and Regulations of the Authority. This audit was performed by Pat Murphy of the Energy and Water Division.

V. DESCRIPTION OF PURCHASED GAS ADJUSTMENT RULE

Actual Cost Adjustment Audits:

The PGA Rule can be found in Chapter 1220-4-7 of the Rules of the Tennessee Regulatory Authority. The PGA Rule permits 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. The PGA consists of three major components:

1. **The Actual Cost Adjustment (hereafter the "ACA")**
2. **The Gas Charge Adjustment (hereafter the "GCA")**
3. **The Refund Adjustment (hereafter the "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 "trues-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. For a more complete definition of the GCA and RA, please see the PGA Formula in Appendix A of this Report.

Section 1220-4-7-.03 (2) of the PGA rule requires:

> Each year, the Company 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. This 180 day notification period may be extended by mutual consent of the Company and the [Authority] Staff or by order of the [Authority].

Prudence Audit of Gas Purchases:

Section 1220-4-7-.05 of the PGA Rule requires, unless otherwise ordered by the Authority, an "Audit of Prudence of Gas Purchases" by a qualified consultant. This specialized audit evaluates and reports annually on the prudence of any gas costs included in the PGA. The Prudence Audit of the gas purchasing activities of Chattanooga was performed by PHB Hagler Bailly for the period July 1, 1998 to June 30, 1999. In its report PHB Hagler Bailly concluded "that AGL, acting on behalf of Chattanooga Gas Company during the period under review, acted prudently, overall, in the areas of gas supply planning and procurement."

VI. SCOPE OF ACA AUDIT

The Company's filing summarized the balance in the Deferred Cost Account at June 30, 1999, as follows:

Beginning Balance @ 6/30/98	$ 1,178,687
Activity during year ended 6/30/99:	
Gas Purchases	33,566,253
Gas Recoveries	(34,007,227)
Interest accrued during year ended 6/30/99	68,859
ENDING BALANCE @ 6/30/99	$ 806,571

We performed this audit to ascertain that the Company's calculations of gas costs incurred and recovered were correct. Also included in this audit were several prior period adjustments: ACA refunds and surcharges, an Interruptible Margin Credit Rider (IMCR) adjustment, a Weather Normalization (WNA) adjustment, and SS-1 negotiated margin loss adjustments.

A PGA filing was made with the TRA on June 29, 1999 to implement the surcharge for the 1997-1998 ACA balance as recommended by Staff in the last audit. On November 2, 1999, the Company made a PGA filing to implement a surcharge that included the remaining balances in the 1993-1994, 1994-1995, 1995-1996, 1996-1997 ACA filings and the current surcharge for the 1998-1999 ACA balance. Staff concludes that all refunds/surcharges have now been implemented by the Company.

We also reviewed the off-system sales of the Company for the current audit period. In the last audit, Staff reported that 76% of the Company's off-system sales of $16,083,482 were made to affiliates of the Company. During this audit period, off-system sales declined to $2,742,249 of which 26% of sales were to affiliates. Staff does not perceive a preference being afforded to Company affiliates, but will continue to monitor these sales as part of the ACA process. The Company's Interruptible Margin Credit Rider (IMCR) permits the Company to retain 50% of the gross profit from these sales and requires the Company to file annually with the TRA its calculations of profits/losses incurred under this Rider. The last IMCR filing was made on September 29, 1998. The Company states that at this time they are reconciling the account and will make another filing by May 1, 2000.

We 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. Since the Company's billing process is computerized, a sample of 68 bills was tested. These bills were selected to be representative of the residential, commercial, industrial and interruptible customers in the Company's service area. The sample was selected from the twelve-month period of July 1, 1998, through June 30, 1999. After recalculating each sample bill, we determined that the calculation methods utilized by the Company are correct.

VII. ACA FINDINGS

As previously stated, the Company's Actual Cost Adjustment filing dated October 4, 1999, reflected a net under-collection of gas costs from customers for the year ended June 30, 1999, of \$806,571.66. The net effect of the Staff's findings, which are detailed below, increase the under-collection by \$68,700.16 to \$875,271.82. Effective December 1, 1999, the Company began surcharging its customers for the under-collection.

SUMMARY:

FINDING #1	Commodity Recovery	\$ 65,961.16	under-recovery
FINDING #2	Interest Accrual	2,769.00	under-recovery
	Net Result	**\$ 68,730.16**	**under-recovery**

A detail explanation for each of the above findings can be found beginning at page 6 of this report.

FINDING #1:

Exception:

The cost of gas recovered from the Company's off-system sales was overstated by $65,931.16.

Discussion:

On November 22, 1999, subsequent to Chattanooga Gas' filing of their Actual Cost Adjustment on October 4, the Company notified Staff of an error that was made in calculating the cost of gas recovered from off-system sales. In the delivery of natural gas, there is a small inherent fuel loss that occurs in the pipeline. In this instance, the cost recovery calculation error occurred when the Company applied a unit cost that included the cost of fuel loss to sales volumes that were already grossed up for the cost of fuel loss. Therefore, the cost of fuel loss was included twice. The result was an overstating of the cost recovery by $65,931.16.

Company Response:

The Company agrees with the finding. As stated in the discussion above, the Company discovered the error after making its ACA filing and subsequently informed the TRA Staff of the error.

FINDING #2:

Exception:

The Staff calculated an underrecovery of $2,769 in the commodity interest accrual.

Discussion:

As a result of the above finding related to the commodity portion of the ACA, the commodity interest accrual has been understated by $2,769.

Company Response:

The Company agrees with this finding.

APPENDIX A

PGA FORMULA

The computation of the GCA can be broken down into the following formulas:

$$\text{Firm GCA} = \frac{D + DACA}{SF} - DB + \frac{P + T + SR + CACA}{ST} - CB$$

$$\text{Non-Firm GCA} = \frac{P + T + SR\ CACA}{ST} - CB$$

where

GCA	=	The Gas Charge Adjustment in dollars per Ccf/Therm, rounded to no more than five decimal places.
D	=	The sum of all fixed Gas Costs.
DACA	=	The demand portion of the ACA.
P	=	The sum of all commodity/gas charges.
T	=	The sum of all transportation charges.
SR	=	The sum of all FERC approved surcharges.
CACA	=	The commodity portion of the ACA.
DB	=	The per unit rate of demand costs or other fixed charges included in base rates in the most recently completed general rate case (which may be zero if the Company so elects and the Commission so approves).
CB	=	The per unit rate of variable gas costs included in base rates in the most recently completed general rate case (which may be zero if the Company so elects and the Commission so approves).
SF	=	Firm Sales.
ST	=	Total Sales.

The computation of the RA can be computed using the following formulas:

$$\text{Firm RA} = \frac{DR1 - DR2}{SFR} + \frac{CR1 - CR2 + CR3 + i}{STR}$$

$$\text{Non-Firm RA} = \frac{CR1 - CR2 + CR3 + i}{STR}$$

where

RA	=	The Refund Adjustment in dollars per Ccf/Therm, rounded to no more than five decimal places.
DR1	=	Demand refund not included in a currently effective Refund Adjustment, and received from suppliers by check, wire transfer, or credit memo.
DR2	=	A demand surcharge from a supplier not includable in the GCA, and not included in a currently effective Refund Adjustment.
CR1	=	Commodity refund not included in a currently effective Refund Adjustment, and received from suppliers by check, wire transfer, or credit memo.
CR2	=	A commodity surcharge from a supplier not includable in the GCA, and not included in a currently effective Refund Adjustment.
CR3	=	The residual balance of an expired Refund Adjustment.
i	=	Interest on the "Refund Due Customers" account, using the average monthly balances based on the beginning and ending monthly balances. The interest rates for each calendar quarter used to compute such interest shall be the arithmetic mean (to the nearest one-hundredth of one percent) of the prime rate value published in the "Federal Reserve Bulletin" or in the Federal Reserve's "Selected Interest Rates" for the 4th, 3rd, and 2nd months preceding the 1st month of the calendar quarter.

SFR = Firm sales as defined in the GCA computation, less sales under a transportation or negotiated rate schedule.

STR = Total sales as defined in the GCA computation, less sales under a transportation or negotiated rate schedule.