

OFFICE OF GENERAL COUNSEL

April 15, 2005

TO ALL PARTIES OF RECORD

Gas Utilities Docket No. 9364

Joint Petition of CenterPoint Energy Entex and the City of
Tyler

Examiners' Letter Transmitting Proposal for Decision

Attached is a Proposal for Decision (PFD) submitted by the Examiners in this docket. This is only a proposal and should not be interpreted as a final decision unless a final order is signed and issued by the Commission.

NOTE: Pursuant to 16 Tex. Admin. Code §§ 1.141(a) and 1.142(a), you may file written exceptions to the proposed order or present briefs to the Commission. It is the Examiners' intention to post this item for the May 10, 2005, Conference, the alternative date noted in Examiners' Letter No. 38. You must file your exceptions, briefs, and/or summaries with the Docket Services Section of the Office of General Counsel (Room 12-112) by Monday, April 25, 2005. Replies to exceptions must be filed by 2:00 p.m., Monday, May 2, 2005.

The time frame for Exceptions and Replies is similar to the time frame originally set out, and agreed by the parties, in Examiners' Letter No. 54. A regularly scheduled conference is also currently set for May 24, 2005. Any party desiring additional time is directed to file a request with the Examiners, prior to April 25, 2005. In the event a request is filed by either party, the time set out in 16 Tex. Admin. Code § 1.142, shall apply. Accordingly, in that event, Exceptions must be filed on Monday, May 2, 2005, Replies will be due on Thursday, May 12, 2005.

Pleadings are considered filed only upon actual receipt by the Docket Services Section. An original and eleven copies of exceptions, replies and summaries should be submitted to the Commission. Please do not staple. In addition, if practicable, parties are requested to provide the Examiners with a copy of any filings on diskette in Word or WordPerfect format. The diskette should be labeled with the Docket Number, the title of the document, and the format of the document.

Any revisions or modifications made by the Examiner in response to the exceptions, replies, briefs, and/or summaries will be served on all parties.

You will be notified by mail of any final decision or order of the Commission.

Eugene Montes
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attachments

OFFICE OF GENERAL COUNSEL

GUD Docket No. 9364

JOINT PETITION OF CENTERPOINT ENERGY ENTEX AND THE CITY OF TYLER FOR REVIEW OF CHARGES FOR GAS SALES

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CenterPoint Energy Entex (Entex)

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

JOINT PETITION FILED:	October 20, 2004
HEARING DATES:	December 7 - 10, 16 - 17, 2004 January 6, 2005
HEARD BY:	Gene Montes, Hearings Examiner Mark Brock, Technical Examiner
RECORD CLOSED:	January 6, 2005
PFD CIRCULATION DATE:	April 15, 2005

STATEMENT OF THE CASE

The case involves an examination of the gas purchase practices of CenterPoint Energy Entex (Entex) during the period from November 1, 1992, through October 31, 2002. The parties to this proceeding refer to that period as the Review Period. This case is focused on the gas purchase practice of Entex during the Review Period for service provided within the City of Tyler. The City of Tyler ceded its jurisdiction to the Railroad Commission (Commission) to review Entex's charges for gas sales during the Review Period. Specifically, the City of Tyler seeks a determination of whether the gas purchases were lawful, complied with the Gas Utility Regulatory Act, applicable municipal regulations and franchises, filed tariffs and applicable Commission regulations. Further, the City of Tyler seeks a determination by the Commission regarding the gas management practices of Entex and whether those practices were prudent.

SUMMARY OF MAJOR ISSUES

During the Review Period the City of Tyler alleges that Entex engaged in management practices that favored one group of customers, referred to as the TGM Exhibit B Customers. That practice was discriminatory in relation to the commercial customers. The pricing structure resulted in discrimination between commercial customers and the TGM Exhibit B Customers. The structure was also discriminatory for members within two classes of customers designated by Entex as Class 3 and Class 5. It was not discriminatory, however, with regards to the residential and commercial customers as a combined group. The claimed discrimination was not the basis for any of the alleged refunds calculated by the City of Tyler.

Allegations regarding violations of the various tariffs were the basis for two refund amounts. First,

the City of Tyler alleged that Entex violated its tariffs by not commingling gas purchases for calculation of the weighted average cost of gas. Entex, on the other hand, argued that the filed tariffs required assignment, or matching, of gas costs. Thus, a combined weighted average cost of gas was not permitted by the filed tariffs. The City of Tyler estimated that a refund based on a combined weighted average cost of gas would be \$8,209,909. The Examiners found that the tariffs, in fact, required the assignment of gas costs and did not permit the calculation of a combined weighted average cost of gas. Second, the City of Tyler also alleged that Entex improperly passed through capital expenditures as part of the gas costs that it passed through to customers. Capital improvement costs are not associated with the acquisition of gas costs and cannot be recovered through the purchase gas adjustment clause. That amount was estimated by the City of Tyler as \$5,200,000. The Examiners concluded that the record did not establish that Entex inappropriately passed through capital costs.

In addition to the claims of tariff violations, the City of Tyler also alleges that Entex did not manage its gas costs prudently during the Review Period. Two aspects of Entex's management practices were the focus of this case. First, the City of Tyler argued that Entex paid an unreasonably high price for natural gas and estimated that customers were overcharged \$35,563,801. Entex established that the price paid was reasonable, and that service for the entire Tyler IDS could not have been obtained at a lower price. Second, the City Tyler argued that Entex failed to act prudently by not renegotiating the price of the contract at the first opportunity. The City of Tyler estimated that the delay cost residential and commercial customers \$2,650,021. The Examiner conclude that the record in this case established that it was prudent to wait one year before renegotiating the contract price.

Finally, the City of Tyler alleged that Entex engaged in affiliate transactions that increased the differential between the residential and commercial customers and the industrial customers within the City of Tyler. In addition, the City of Tyler argues that Entex violated the affiliate transaction standard by selling natural gas to Entex at a higher price than the price sold to industrial customers of the affiliate. The City of Tyler estimated Entex's affiliate overcharged the residential and commercial customers approximately \$199,000 during the review period. The Examiners conclude that the affiliate service to the industrial customer was not comparable to the service provided to Entex. Therefore, the Examiners find that Entex has not violated the affiliate transaction standard. In addition, the Examiners find that Entex properly assigned its gas costs to the industrial customer as set out in Entex's tariffs.

The City of Tyler has requested \$1,142,124 in actual expenses. Entex has requested \$1,598,366 in rate case expenses. Thus, the total actual rate case expenses at issue are \$2,740,490. The Examiners recommend that the amounts requested for rate case expenses be adjusted. The City of Tyler should recover no more than \$1,070,933.87; Entex should recover no more than \$1,079,344.14. Thus, the Examiners recommend that the total amount of rate case expenses be \$2,150,278.01. The Examiners recommend that, of that amount, Entex be allowed to recover \$2,007,787.26 through a surcharge.

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I. Procedural Background

a. Procedural History through the filing of the Joint Petition

The issues in this docket began when the City of Tyler and Entex entered into a new franchise agreement in 1990 that would govern Entex's activities within the City of Tyler until 2000.¹ In part, due to the expiration of that franchise agreement, the City of Tyler began examining issues related to Entex's franchise agreement in 1997. After the expiration date, the City of Tyler continued its analysis of gas costs and ultimately focused its review on Entex's treatment of gas costs for the decade from November 1, 1992, through October 31, 2002 (Review Period). The City of Tyler notified Entex that it would commence a hearing on September 25, 2002, to consider the propriety of Entex's gas purchase practices and consider alleged overcharges to residents in the amount of \$39,228,061.

On September 17, 2003, Entex filed a petition at the Railroad Commission seeking a declaratory judgment entitled, *Petition of Reliant Energy Entex for Declaratory Order* ("Petition for Declaratory Order").² The petition initiated GUD No. 9337, wherein Entex contended that the City of Tyler lacked the authority to require refunds. Entex cited the following language of the Gas Utility Regulatory Act:

After notice and hearing, the Railroad Commission, may in the public interest, order a gas utility to refund with interest compensation received in violation of this section.³

Entex argued that this language provided that the Railroad Commission has exclusive jurisdiction to determine the amount, if any, of a refund.⁴ Entex sought a declaratory order from the Commission that Entex had, in accordance with its filed residential and commercial tariffs, properly charged and collected gas costs during the Review Period.⁵ Entex also argued that a prudence review of its gas costs management practices during a historic period was not authorized by the Texas Utilities Code.⁶ Although Entex argued that a prudence review of its past gas costs management practices was not authorized, Entex pointed out that the City of Tyler could have initiated a rate case to prospectively modify the methodology

¹ Entex Exhibit 16.

² Tex. R.R. Comm'n, *Petition of Reliant Energy Entex for Declaratory Order*, Docket No. 9337 (Gas Utils. Div. Sept. 17, 2002) (Petition) ("GUD No. 9337").

³ TEX. UTILITIES CODE ANN. § 104.005(c) (Vernon 1998 & Supp. 2004).

⁴ *Petition for Declaratory Order*, p. 3 & 6.

⁵ *Id* at 3.

⁶ *Id* at 10.

used by Entex to recover gas costs from the Tyler Integrated Distribution System (Tyler IDS).⁷ In addition, Entex argued that an affected party or the Commission may initiate a complaint proceeding at any time to determine whether a gas utility has charged unreasonable or violative existing rates.⁸ Entex simultaneously filed suit in district court to enjoin the pending City of Tyler hearing.⁹ The parties entered into discussions to determine the appropriate venue for resolution of issues related to the purchase gas adjustment clause (PGA). The parties ultimately agreed to bring the case to the Commission as an original jurisdiction matter.

Before the Commission was able to take jurisdiction over this matter, however, it was necessary for the City of Tyler to cede jurisdiction to the Commission. The Gas Utility Regulatory Act, TEX. UTIL. CODE ANN. §§ 101.001-124.002 (Vernon 1998 & Supp. 2004) (“GURA”) establishes the respective jurisdiction of municipalities and the Railroad Commission. Pursuant to section 103.001, municipalities have exclusive original jurisdiction over the rates, operations, and services of a gas utility within the municipality. Pursuant to section 104.003, the municipality has the authority to ensure that each rate a gas utility makes, demands, or receives is just and reasonable.

On January 8, 2003, the City of Tyler ceded its rate review jurisdiction on the limited issue of “whether Entex properly and lawfully charged and collected for gas sales to residential and commercial customers in the City of Tyler during such period, to consider any appropriate remedies, including but not limited to, refunds, with interest, and to enter such orders as may be appropriate.”¹⁰ The City of Tyler emphasized that this was a limited surrender of its jurisdiction and retained “full and complete original jurisdiction over the rates, operations, and services of CenterPoint Energy Entex within the City.”¹¹

This case was subsequently filed with the Commission on January 22, 2003, and designated GUD No. 9364. The district court proceeding and GUD No. 9337 were simultaneously dismissed.¹² The scope of this proceeding was set out by agreement of Centerpoint Energy Entex (“Entex”) and the City of Tyler (“City”) in the *Joint Petition for Review of Charges for Gas Sales* (“*Joint Petition for Review*”):

⁷ *Id.* at 11, citing TEX. UTILITIES CODE ANN. § 103.001. (Vernon 1998 & Supp. 2004).

⁸ *Id.* citing TEX. UTILITIES CODE ANN. §§ 104.151 - 152, and 105.051. (Vernon 1998 & Supp. 2004).

⁹ *Reliant Energy Entex v. City of Tyler et al.*, No. GN203392 (201st Dist. Ct., Travis County), *Plaintiff’s Original Petition for Declaratory and Injunctive Relief*.

¹⁰ Ordinance No. 0-200-3, *An Ordinance of the City of Tyler, Texas Surrendering to the Railroad Commission of Texas Jurisdiction over Gas Utility Rate, Operations, and Services of Centerpoint Energy Entex Attributable to the Period November 1, 1992 through October 31, 2002, Providing that this Ordinance is Cumulative, and Establishing an Effective Date* (January 8, 2003).

¹¹ *Id.*

¹² GUD No. 9337, Order of Dismissal, February 14, 2003.

Entex and the City request that the Commission initiate a proceeding to determine whether Entex has properly and lawfully charged and collected for gas sales to residential and commercial customers served from the Tyler Integrated Distribution System (“TIDS”) during the period from November 1, 1992 to October 31, 2002, to consider any appropriate remedies, including but not limited to, refunds, with interest, and to enter such orders as may be appropriate.

On May 15, 2003, the case was referred to the State Office of Administrative Hearings (“SOAH”). On June 18, 2003, Governor Perry signed House Bill 2846, 78th Leg. R.S., (2003) which repealed TEX. UTIL. CODE § 102.006 and TEX. GOV’T CODE § 2003.0491, effectively returning to the Commission the function of conducting hearings in gas utility contested cases. *See also*, HB 2846, 78th Leg. R.S. (2003). On July 24, 2003, the SOAH Administrative Law Judge issued Order No. 3 and returned the docket to the Railroad Commission of Texas. A dispute between the parties immediately arose regarding the appropriate scope of this proceeding.

b. Scope of Proceeding

Almost since its inception at the Commission, the parties have disputed the meaning of the agreed language in the *Joint Petition* and the appropriate scope of these proceedings. The parties vastly divergent views as to the scope of this proceeding became evident as early as February 18, 2003, less than one month after the case was filed, when Entex filed its response to the City of Tyler’s *Motion for Entry by the Commission of an Order of Referral and Preliminary Order*. The central issue was whether or not the scope of this proceeding should include consideration of the reasonableness and necessity of all Entex’s gas costs and gas purchase practices from November 1, 1992, to October 31, 2002. Generally, the City of Tyler, on the one hand, argued that proceeding includes a “prudence review” of past purchases.¹³ On the other hand, Entex argued that the Commission lacked the authority to conduct a retroactive prudence review and that this case should be limited to an audit of gas costs flowed through to customers.¹⁴

The Examiners concluded, in **Examiners’ Letter No. 5**, that a review of the tariffs and ordinances

¹³ The City of Tyler repeated its position in several filings: *City of Tyler’s Reply to Entex’s Response to The City’s Motion for an Order of Referral and Preliminary Order*, February 26, 2003; *City of Tyler’s Response to Entex’s Request for Prehearing Conference and that Discovery Be Abated*, February 27, 2004; *City of Tyler’s Interim Appeal of Examiner’s Ruling Stopping All Discovery and Failing to Rule on Cost Reimbursement*, March 12, 2004.

¹⁴ Entex repeated its position in several filings. *Objections of Centerpoint Energy Entex to the City of Tyler’s First Request for Production of Documents, and First Set of Written Interrogatories*, February 17, 2004; *Request of CenterPoint Energy Entex to Set Pre-Hearing Conference to Establish Briefing Schedule on Legal Scope of Proceeding*, February 17, 2004; *Response of CenterPoint Energy Entex to the City of Tyler’s Motion for Rate Case Expense Reimbursement*, February 27, 2004; *Response of CenterPoint Energy Entex to Examiners’ Letter No. 3*, April 23, 2004.

filed by the parties on March 29, 2003, revealed that the tariffs *may*, or *may not*, contain defenses to claims alleged by the City of Tyler.¹⁵ The ability to raise a defense, however, did not deprive the Commission of the jurisdictional authority to consider a complaint regarding the past purchase practices of Entex. In the past, the Commission has asserted its authority to conduct this type of prudence review.

The Commission has previously asserted that authority in GUD No. 8647, *Inquiry into the Rates and Services of Lone Star Gas Company, Lone Star Pipeline Company, and Lone Star Gas Company-Transmission Division, Divisions of Enserch*, Gas Utilities Docket No. 8647 (1998). Although, that case was ultimately settled, and Entex implied that the Commission did not squarely decide the jurisdictional issue in that case, the Commission clearly asserted its jurisdiction to conduct such a review in GUD No. 8664. In that case, *Statement of Intent of Lone Star Gas Company and Lone Star Pipeline Company, Divisions of Enserch Corporation, and Ensar Pipeline Company to Increase the Intracompany City Gate Rate*, GUD No. 8664 (November 25, 1997), the Commission specifically ordered that “consideration of the reasonableness and necessity of all Lone Star’s gas costs and gas purchase practices and the application of its PGA (GCAC) from the date of the final order in GUD No. 3543” through the date of that order was severed for consideration in GUD No. 8647. In other words, the Commission ordered a consideration of the reasonableness of the utility’s gas purchases for an historic period — November 22, 1982¹⁶ through November 25, 1997.

In this case, the City of Tyler came to the Commission seeking to present a case regarding the past gas purchasing practices of Entex. Accordingly, to the extent it was raised by the City of Tyler, the Examiners concluded that issues related to a consideration of the reasonableness and necessity of Entex’s gas costs and gas purchase practices should be considered in this proceeding. Entex appealed the decision of the Examiners. The Commission denied the appeal and issued its order on May 11, 2004. Thereafter, Entex filed a suit in district court seeking a declaration of the Commission’s authority to conduct a proceeding that included issues related to a consideration of the reasonableness and necessity of Entex’s gas costs and gas purchase practices.¹⁷ On November 19, 2004, the district court issued an order denying the requested declaratory relief. Entex appealed the district court’s judgment and the appeal is now pending. Entex also filed with the Third Court of Appeals an *Original Petition for Writ of Prohibition*

¹⁵ The City of Tyler acknowledged this fact by including in a proposed order listing issues to be considered in this case: A defense that the Commission has no authority to review whether Entex’s charges passed through the purchased gas adjustment clause were proper, just, reasonable, and lawful, so long as Entex complied with the literal or express language of its tariffs.

¹⁶ November 22, 1982, was the date that the prior order authorizing the utility’s PGA was entered. *Statement of Intent filed by Lone Star Gas Company to Change the Intracompany City Gate Rate*, GUD No. 3543.

¹⁷ Center Point Energy Entex v. Railroad Commission of Texas, et al, 353rd Judicial District Court, Travis County, Texas, Cause No. GN4-02169.

*or Injunction to Preserve the Court's Jurisdiction.*¹⁸

In another order issued by the Commission on July 6, 2004, the Commission granted an appeal of **Examiners' Letter No. 16**, and ruled that the City of Tyler may recover its rate case expenses in this proceeding. Further, the City of Tyler's motion for monthly reimbursement of 90% of its expenses was granted.

On May 6, 2004, the City of Tyler filed its *Statement of Issues* in this case. That document, and the rulings of the Commission on May 11 and July 6, 2004, have largely governed the scope of this proceeding. The *Statement of Issues* incorporated all of the prior assertions by the City of Tyler regarding the scope of this case. Entex filed its response to the *Statement of Issues* on May 18, 2004. Entex argued that the *Statement of Issues* continued to be vague and did not put Entex on notice regarding some of the issues to be raised in this case. Further, Entex pointed out that nowhere did the City of Tyler provide any legal authority by which the Commission can determine issues related to conspiracy, collusion, or order civil penalties. Nevertheless, Entex's request to limit issues raised by the City of Tyler was denied in **Examiners' Letter No. 25**. The City of Tyler filed an *Amended Statement of Issues* on October 1, 2004, expanding slightly the scope of this proceeding. The issues raised in Entex's response to the original *Statement of Issues* were not addressed in that document. The scope of this proceeding was further defined by the City of Tyler in the context of a discovery dispute that arose among the parties in November, 2004. In resolving the dispute the Examiners' ruled that the transactions of Entex's affiliates were a part of this proceeding. Entex appealed that decision. The Commission denied the appeal, and affirmed the Examiners' decision in favor of the City of Tyler.

c. Procedural Schedule

The original procedural schedule established in this case established January, 2005, as the month in which this case would be presented at Conference for Commission consideration. At the request of the parties that date was changed, and the Examiners designated a target date for presentation of this case to the Commission on either April 25, 2005, or May 10, 2005. In **Examiners' Letter No. 15**, the Examiners issued a procedural schedule in the case and maintained the original deadline for presentation to the Commission in January of 2005. On June 3, 2004, the City of Tyler filed a *Motion to Suspend the Procedural Schedule and Abate Proceedings*. That motion was granted and on July 7, 2004, a revised procedural schedule was issued in this case. Again, the goal of that schedule was to present this case to the Commission in January of 2005. On July 16, the City of Tyler filed a motion to vacate the deadline for written discovery. On July 27, 2004, that motion was granted and the City of Tyler's proposed procedural schedule was adopted. The goal of that schedule was to have this case prepared for Commission consideration in March of 2005.

¹⁸ In Re CenterPoint Energy Entex, Cause No. 03-04-00717-CV.

At the conclusion of the hearing in December 2004, the parties requested a modification of the Procedural Schedule set out in **Examiners' Letter No. 21**. The request was granted and a revised procedural schedule was issued on January 7, 2005. That schedule projected a conference presentation date of March 22, 2005. The parties, at the request of the City of Tyler, again requested a modification of the procedural schedule and on January 19, 2005, the schedule was again modified. That schedule indicated that the proposed conference date would occur on either April 25, 2005, or May 10, 2005. On March 28, 2005, the Examiners, on their own motion, modified the procedural schedule. The projected conference presentation date was not altered by that schedule. The Examiners indicated their goal of presenting this case to conference on April 25, 2005. On April 4, 2005, the procedural schedule was abated, to allow additional time to review and evaluate the record in this case.

As set out in the *Revised Procedural Schedule* issued on July 27, 2004, (*Revised Procedural Schedule of July 27th*), December 7, 2004 was established as the date on which the hearing on the merits would commence. The parties, pursuant to the schedule set out in the *Revised Procedural Schedule of July 27th*, timely filed their direct testimony. On October 11, 2004, the City of Tyler filed its Direct Testimony in this case. Entex filed its Direct Testimony on July 27, 2004. The *Revised Procedural Schedule of July 27th* was modified on September 13, 2004. The Examiners, in **Examiners' Letter No. 26**, clarified that the City of Tyler's rebuttal testimony could address all issues raised in the direct testimony. An opportunity for Entex to file rebuttal testimony was granted. Entex's rebuttal testimony was limited to issues on which it had the burden of proof, issues related to its historic gas purchase costs, raised in the rebuttal testimony to be filed by the City of Tyler. The Examiners also indicated that Entex's rebuttal witnesses would be tendered for cross examination on December 13, 2004. The *Revised Procedural Schedule of July 27th* set November 22, 2004, as the deadline for the City of Tyler to file its rebuttal testimony. A motion was filed to extend that deadline, by agreement of the parties, to November 29, 2004, and that motion was granted by the Examiners.

At a prehearing conference held on November 30, 2004, six days after the City of Tyler filed its Rebuttal Testimony, an oral motion to file supplemental testimony was made by the City of Tyler. The City of Tyler sought to file additional testimony regarding affiliate transactions issues. Entex argued that the affiliate issues had not previously been raised. The City of Tyler's motion, however, was granted.¹⁹ In order to allow Entex an opportunity to adequately respond to the supplemental testimony and issues raised therein, the Examiners determined that the hearing in this case was to be bifurcated. Phase I was to address all issues that had been raised by the parties except rate case expenses and affiliate transaction issues, addressed in the supplemental testimony that was to be filed by the City of Tyler. On December

¹⁹ It should be noted that Entex objected to the motion and argued that the City of Tyler had been in possession of much of Entex's affiliate information since May 27, 2004, and all of the affiliate information since October 26, 2004. *Objection and Motion to Strike Adverse Testimony of Rollie Bohall and Supplemental Testimony of William Fowler and Donald Niemiec*, p. 1.

2, 2004, the City of Tyler filed its supplemental testimony regarding affiliate transaction issues. Entex filed its rebuttal testimony on all issues except those issues raised by the City of Tyler's December 2, 2004, supplemental testimony.

The *Revised Procedural Schedule of July 27th* and the subsequent modification did not provide for any additional testimony to be filed in this case. On December 2, 2004, however, the City of Tyler filed the testimony of Rollie Bohall. Mr. Bohall was being called as an adverse witness by the City of Tyler. The prefiled testimony was a one hundred and fifty-six page deposition. The issues raised in Mr. Bohall's testimony did not primarily address affiliate transaction issues and was filed five days before the hearing was to commence in this case. Entex filed objections to the deposition testimony of Mr. Bohall, arguing that the deposition should be stricken because it was filed in disregard of the procedural schedule and the City of Tyler had not designated specific portions of the deposition relevant to this proceeding.²⁰ The Hearings Examiner ruled that the testimony should be stricken.²¹ Nevertheless, the Hearings Examiner allowed the City of Tyler to refile the testimony and designate particular portions to be included in the record. The City of Tyler refiled the portions of the testimony that the City of Tyler believed were relevant to these proceedings. Although no prior motion to modify the procedural schedule had been filed by the City of Tyler, and although the Examiners found that Entex had not hindered the scheduling of the deposition, the Examiners ruled that the portions designated by the City of Tyler would be allowed as prefiled testimony in support of issues raised in Phase I and Phase II of the hearing.²²

d. Customer Correspondence

At the end of February, after the conclusion of the evidentiary portion of this case, and continuing through most of March, 2005, several Entex customers, at the request of the City of Tyler, began filing letters in this case complaining about rates and services charged by Entex. Over four hundred letters were filed comprising over seven hundred pages. On March 3, 2005, after reviewing several hundred letters, the Examiners issued **Examiners' Letter No. 48**, requesting that Entex, and the City of Tyler work together to contact each customer. **Examiners' Letter No. 48**, attached as **Exhibit 1**, summarizes the letters filed through that date. Pursuant to **Examiners' Letter No. 48**, Entex contacted each customers to address concerns raised in that correspondence. The City of Tyler indicated that it was provided a copy

²⁰ See, Objection and Motion to Strike Adverse Testimony of Rollie Bohall and Supplemental Testimony of William Fowler and Donald Niemiec, and *Objection of CenterPoint Energy Entex to Deposition Testimony of Rollie G. Bohall*. filed on December 6, 2004.

²¹ Tr. Vol. I, p. 10, lns. 22 - 25.

²² TEX. ADMIN. CODE § 1.121(b)(14): The presiding examiner shall have, but shall not be limited to, the following authority . . . to take other permissive action which is necessary for fair, just, and proper hearing.

of the report filed by Entex, but that it had not contacted any of the customers.²³

The City of Tyler made a motion that those letters be allowed as evidence in this proceeding, or, alternatively, considered as *amicus* filed on behalf of the City of Tyler. The City of Tyler did not designate which letters should be made part of the record. Entex argued that those letters, were not evidence in this proceeding, should not be considered as *amicus*, and maintained that they should not be a part of the record in this case. The Examiners, having reviewed those letters, do not recommend that the record be reopened to admit them as evidence in this proceeding. As can be seen from **Examiners' Letter No. 48**, the majority of those letters involved matters that were not at issue in this case. Furthermore, to the extent that they involved the gas cost adjustment clause, they were addressed to issues relating to the operation of the current PGA. The Examiners do not agree that they could be construed to apply to issues involving the PGA during the Review Period.

II. Jurisdiction

The Commission has jurisdiction over Entex, and over the matters at issue in this proceeding pursuant to TEX. UTIL. CODE ANN. §§ 102.001, 103.003, 103.051, 104.001, 121.051, 121.052, and 121.151 (Vernon 2004). The statutes and rules involved in this proceeding include but are not limited to TEX. UTIL. CODE ANN. §§ 104.101, 104.102, 104.103, 104.105, 104.106, 104.107, 104.110, 104.301, and 16 TEX. ADMIN. CODE Chapters 1 and 7. The Notice of Hearing was issued on November 18, 2004, and satisfied the requirements of 16 TEX. ADMIN. CODE § 1.45 and of TEX. GOV'T CODE ANN, CHAPTER 2001, and TEX. GOV'T CODE ANN. § 2001.052 (Vernon 2004).

Additionally, the City of Tyler ceded its jurisdiction in this case pursuant to the authority of section 103.002 of the Texas Utilities Code, to consider the issues raised in its Ordinance No. 0-2003-3 on January 8, 2003. A copy of the ordinance is attached as **Exhibit 2**.²⁴

III. Hearing

The Notice of Hearing was issued in this case on November 18, 2004. The scope of the proceeding tracked the scope requested by the City of Tyler in its *Amended Statement of Issues* and is discussed in detail in Section V, below.

On December 7, 2004, Phase I of the hearing commenced. G. William Fowler testified on behalf of the City of Tyler on issues regarding the definition and purpose of a PGA clause; expenses that may be

²³ Post-Hearing Conference, Tr., p. 7 (March 15, 2005).

²⁴ The City of Tyler filed a resolution clarifying the intent of the earlier ordinance ceding jurisdiction. That resolution, dated June 30, 2004, is also included as part of **Exhibit 2**.

properly allowed through a PGA clause; an evaluation of the gas supply contracts and large volume gas sales contracts for the Tyler IDS in light of the PGA clauses and the Franchise Agreement approved by the City of Tyler; whether Entex flowed through the correct gas costs in accordance with the Tyler PGA clauses; and whether the City of Tyler's franchise agreement was violated. Donald W. Niemiec testified on issues regarding the reasonableness of Entex's gas supply contract arrangements and gas supply costs during the Review Period. Jacob Pous, a principal of the firm of Diversified Utility Consultants, Inc. (DUCI), testified regarding capital investments, the PGA, and quantified the effect of the recommendations asserted by the witnesses of the City of Tyler. Portions of the deposition of Rollie G. Bohall were admitted into the record, on behalf of the City of Tyler, as testimony of an adverse witness.

Charles J. Harder, Executive Director of Rates and Regulatory for CenterPoint Energy Arkla/Entex testified regarding the legal and regulatory basis for matching gas costs to those customer classes for whom the gas was purchased and address filing requirements of Entex. Debra DePeña, the Director of Rates, testified regarding Entex's rates schedules and the PGA clauses approved for Entex; information provided to the City of Tyler and the Railroad Commission; the calculations of the WACOG; and the nature of service provided by Entex under the interruptible large volume class rates schedules filed with the City of Tyler. Joe N. McClendon testified regarding the development of the PGA clauses in Texas and regarding Entex's PGA during the Review Period. George F. Carl, Tyler District Manager for CenterPoint Energy provided an overview of Entex's operations in the Tyler IDS; issues of concern to Entex in the years prior to entering into the TXO and TGM gas supply contracts; and the interactions between Entex and the City of Tyler with respect to gas supply issues. Bruce Coogler, Director of Gas Supply for CenterPoint Energy Entex since 1989, testified regarding Entex's decision-making process in entering into the gas supply contract with TXO Gas Marketing. He also testified about the price redetermination clause and the liquidated damages provisions in the TXO contract. He participated in the negotiations of the TXO and the TGM contracts. David Johnson, who is President of Tributary Engineering & Management Services LLC, testified regarding the TXO and TGM contract. At the time the contracts were negotiated Mr. Johnson was an officer in Delhi, TXO, and TGM. Micheal TheBerge, a consultant with RateMaster Utility Services, testified regarding issues related to the TXO and the TGM contracts. William R. Pennington, a partner with Pendulum Energy, testified on issues regarding the TXO and the TGM contract; the pricing provisions included in the TXO contract; and the differences between the TGM and TXO contract.

Rebuttal testimony in Phase I commenced on December 9, 2004. Testimony on behalf of the City of Tyler was filed by G. William Fowler, Donald W. Niemiec, Jacob Pous, and Gary Landers, the City Attorney for the City of Tyler. He testified about the communication between the City of Tyler and Entex on issues related to the price differential between the TGM contract and the TXO contract. Rebuttal testimony for Entex was filed by Mr. Harder, Ms. DePeña, Mr. McClendon, and Mr. Pennington.

Phase II commenced on December 16, 2004. The City of Tyler presented evidence regarding affiliate issues through the testimony of Mr. Fowler, Mr. Niemiec, and Sara Coleman testified on behalf of the City of Tyler. Entex presented testimony responding to affiliate issues through the testimony of Ms.

DePeña, Wayne D. Stinnet, Mr. Coogler, Mr. Johnson, and Mr. Pennington. Rate case expense testimony was considered on December 17, 2004, and additional rate case expense testimony was considered on January 6, 2005.

IV. Background

The underlying history and legal background critical to determining the issues raised in this case involve four key aspects: First, the physical facilities that make up the Tyler IDS; second, the jurisdictional authority over rates charged by Entex within the Tyler IDS; third, the purpose and legal requirements of purchased gas adjustment clauses; fourth, the gas supply used by Entex to supply the customers of the Tyler IDS.

a. Physical Facilities and Customers Served

Entex has four divisions in Texas that provide distribution service: The Houston Division, the Texas Coast Division, the South Texas Division, and the Entex Beaumont/East Texas Division.²⁵ Entex has provided gas service to the City of Tyler since at least 1982, and its predecessor operated under a franchise agreement issued in 1968.²⁶ Entex's Tyler IDS is part of the Entex/Beaumont East Texas Division and provides natural gas service to approximately 32,000 residential, commercial, and large volume customers in, and adjacent to, the cities of Tyler and Bullard, Texas. The system is spread over a footprint of about 15 square miles. Approximately 26,000 customers are within the City of Tyler, approximately 400 customers are in the City of Bullard, and approximately 5,600 customers are in the unincorporated areas near the City of Tyler. The facilities comprising the Tyler IDS are interconnected and operated as a single, integrated system. The Tyler IDS is not connected to any other Entex distribution system. In this interconnected network, there are mains ranging from two inches to twelve inches in diameter and from operating pressures of four ounces per square inch to lines that are operated at several hundred pounds per square inch.²⁷

Since 1992, there have been two major pipeline connections that provide the Tyler IDS with the majority of its gas supply. One pipeline provides a connection on the north side of town, the North Station, and the other provides a connection to the south side of town, the South Station.²⁸ The connections are currently owned by Enbridge Pipeline, and were previously owned by Koch Midstream and, prior to that, by TXO/Delhi. Entex also receives gas from several local gas wells. The number of gas wells has ranged from six to eight. The current volumetric mix is about 98% pipeline gas and 2% local well deliveries. Entex provides service to the Tyler IDS pursuant to the authority granted in franchises, tariffs and orders issued by the City of Tyler and the Railroad Commission of Texas.

²⁵ Entex Exhibit 4, Direct Testimony of George F. Carl Direct, p. 3, lns. 18 - 21, through p. 4, lns. 1 - 2.

²⁶ Entex Exhibit 3, Direct Testimony of Joe N. McLendon, Exhibit JNM - 1

²⁷ Entex Exhibit 4, Direct Testimony of George F. Carl, p. 3, lns. 5 - 16.

²⁸ Entex Exhibit 8, Direct Testimony of William Rodney Pennington, p. 31, ln. 13.

Entex provides service to several classes of customers: Residential, Small Commercial, and Small Industrial. Most of the residential growth in Tyler has occurred in the southern part of the city.²⁹ Much of this case centers around the service provided to several customers who have been designated, in this case, as the TGM Exhibit B Customers. The TGM Exhibit B Customers are located in the northern part of the city.³⁰ The principle large volume customer, served by an affiliate of Entex, is the LaGloria Refinery,³¹ located on the eastern edge of downtown Tyler. Unlike other customers of Entex, the La Gloria Refinery has had viable alternatives to Entex for its natural gas service.³² The north side of the Tyler IDS contains many of Entex's larger volume customers, while the south side of the Tyler IDS is the area of Tyler that has experienced the most residential and small commercial growth in recent years.³³

b. Regulatory Authority to Provide Service within the Tyler IDS

GURA expressly fixes the respective jurisdictions of municipalities and of the Railroad Commission.³⁴ The City of Tyler must approve rates charged to the customers within its municipal boundary before Entex may charge those rates to its customer. Entex must either obtain approval through a tariff, or order, issued by the City of Tyler for areas within the municipal boundaries of the city. Outside of the municipal boundaries, Entex must obtain approval from the Railroad Commission for rates charged to its customers. The rate schedules in the tariffs, and orders, set forth the price to be paid for utility service, including the cost of gas.³⁵ As noted above, the Tyler IDS provides service to customers within and around the City of Tyler. Throughout the Review Period, rates and service in the Tyler IDS were allegedly authorized by tariffs approved by the City of Tyler, the City of Tyler Franchise Agreements, and orders of the Railroad Commission of Texas.

Between 1966 and the end of the Review Period, the City of Tyler and the Commission have issued several tariffs and orders that set out the rates that Entex was permitted to charge its residential, commercial, and industrial customers. A chronological listing of those relevant to this proceeding begin with

²⁹ Tr. Vol. II, p. 145, ln. 25 & p. 146, lns. 1 - 4.

³⁰ Tr. Vol. II, p. 150, lns. 7 - 15.

³¹ City of Tyler's Written Closing Statement and Initial Brief, p. 2.

³² Tr. Vol. II, p. 174, lns. 14 - 25 & p. 175, lns. 1 - 20.

³³ Entex Exhibit 4, Direct Testimony of George F. Carl, p. 4, lns. 5 - 12.

³⁴ TEX. UTIL. CODE ANN. §§ 102.001 & 103.001 (Vernon 1998 & Supp. 2004). *See, Arkansas Louisiana Gas Company v. Railroad Commission of Texas*, 586 S.W.2d 643, 644 (Tex. 1979).

³⁵ Entex Exhibit 2, Direct Testimony of Debra DePeña, p. 4, lns. 4 - 8.

a franchise agreement approved in 1966.³⁶ Within the City of Tyler, natural gas service was provided to customers pursuant to that franchise, which expired on April 5, 1983. In 1982, a rate ordinance was adopted, followed by separate ordinances filed on September 7, 1984, and December 17, 1985. A new franchise was approved by a City of Tyler rate ordinance dated April 17, 1990.³⁷ In the Environs, two orders were issued by the Commission which affected service to customers of the Tyler IDS: On March 14, 1983, the Commission issued an order in Tex. R.R. Comm'n, *Statement of Intent Filed by Entex, Inc. to Change Rates to an Industrial Customer*, Docket No. 3706 (Gas Utils. Div. March 14, 1983) (final order granting application) ("GUD No. 3706") and on April 25, 1983, the Commission issued an order in Tex. R.R. Comm'n, *Statement of Intent filed by Entex, Inc. to Change its Purchased Gas Adjustment Clause Applicable to the Residential and Commercial Customers in the Environs of Tyler, Texas, and an Inquiry into the Reasonableness of the Impact of Rate Schedule No. 1544 Filed by Entex, Inc. Applicable to Certain Industrial Customers in Smith County, Texas, on the Weighted Average Cost of Gas Charged its Other Customers in the Company's East Texas Division*, Docket No. 3666 (Gas Utils. Div. April 25, 1983) (final order granting application) ("GUD No. 3666"). A time line summarizing the approval of these tariffs, orders, and franchise orders is attached as **Exhibit 3**.

In addition, throughout the Review Period, Entex filed several tariffs, which it designated as negotiated rate tariffs. A negotiated rate tariff supports rates charged to an interruptible customer who, in exchange for a rate that is discounted from the rate for firm service, agrees that its natural gas service may be suspended, or interrupted, for some period of time. The authority to contract for those rates is found in section 104.003 of the Texas Utilities Code. That section provides that a rate for a "pipeline-to-pipeline transaction or a transportation, industrial, or similar large volume contract customer is considered to be just and reasonable and shall be approved by the regulatory authority if certain conditions are met."³⁸ The interruptible tariffs were allegedly filed pursuant to the authority of section 104.003, and include the following: Rates Schedules No. 1549, 1696, 1817, 1834, 1977, 2007, 2014, 2027, 2058, 2077, 2131, 2141, 2184, 2223, 2228, 2225, 2250, 2254, 2305, 2326, 2332, 2340, 2367, 2402, 2461, 2461, and 2250.³⁹ Copies of selected tariffs, specifically addressed at the hearing, are attached collectively as **Exhibit 4**. Those tariffs were intended to govern the rates charged to the TGM Exhibit B Customers. Unlike the other tariffs governing residential and commercial customers, these tariffs were not approved through a Statement of Intent, or other order of the City of Tyler. These tariffs were simply filed with the City of Tyler. (The residential and commercial tariffs, as will be seen, were reviewed and approved via a city

³⁶ Entex Exhibit 1, Direct Testimony of Charles J. Harder, Exhibit CJH - 2 & Entex Exhibit 19.

³⁷ Entex Exhibit 16.

³⁸ TEX. UTILS. CODE ANN. § 104.003(b).

³⁹ See, Entex Exhibit 3, Direct Testimony of Joe N. McClendon, Exhibit, JNM -1, pp. 31 - 43; Entex Exhibit 9, Rebuttal Testimony of Charles Harder, p. 6, lns. 8 - 9; Entex Exhibit 10, Rebuttal Testimony of Debra DePeña, Exhibit DD-R-1; Examiners' Exhibit 2; *City of Tyler's Reply to Entex's "Initial Post-Hearing Brief,"* Appendix A.

ordinance.) Entex also filed Rate Schedule No. 590 which was applicable to certain customers within the Tyler IDS. A copy of that tariff is attached as **Exhibit 5**. That tariff, also filed as a negotiated rate tariff, applied to any consumer for commercial uses, and industrial uses, who consumed over 150,000 cubic feet of gas in any one month.⁴⁰

The City of Tyler approved an ordinance authorizing a purchased gas adjustment provision for residential customers (Rate Schedule No. R-674-2) and small commercial customers (Rate Schedule No. SC-674-2) in 1982. Based upon those rate schedules, whenever the cost of gas increased or decreased, the rates to the customer would be adjusted. The City of Tyler also authorized the adoption of Rate Schedule No. 1544, attached as **Exhibit 6**, in 1982, for large industrial customers using in excess of 1,000 Mcf per day on an annual daily average basis for interruptible transportation gas.⁴¹ Copies of the Residential Rate Schedule No. R-674-2 and Small Commercial Rate Schedule No. SC-674-2, are attached as **Exhibit 7** and **Exhibit 8**, respectively.

In 1982, Entex also instituted a proceeding at the Commission to invoke the Commission's environs jurisdiction. Entex sought to have the same rates made applicable to customers outside the Tyler city limits that were approved within the City of Tyler.⁴² The Commission Final Order, GUD No. 3666, approved the same rates as had the City of Tyler. GUD No. 3666 states that the proposed PGA would "allow Entex to aggregate a package of low cost, curtailable gas purchased from the interstate market for the exclusive use of certain of its industrial customers in Smith County, Texas."⁴³ The result was that the cost of curtailable or interruptible gas purchased for the industrial customer was allowed to be segregated from the residential and small commercial customers when calculating their WACOG for PGA purposes.⁴⁴ A copy of the final order issued in GUD No. 3666 is attached as **Exhibit 9**.

In September 1984, the City of Tyler approved another ordinance authorizing a purchased gas adjustment provision for residential customers (Rate Schedule No. R 832-2) and small commercial customers (Rate Schedule No. SC 832-2) that had a base cost of gas of \$4.5705 per Mcf. These tariffs replaced the earlier residential and commercial tariffs. As with the prior rate schedules, the PGA fluctuated, whenever the cost of gas increased or decreased.⁴⁵ The Residential Rate Schedule No. R-832-2

⁴⁰ Entex Exhibit 3, Direct Testimony of Joe N. McClendon, Exhibit JNM - 1.

⁴¹ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 12, Ins. 16 - 24. Entex Exhibit No. 2, Direct Testimony of Debra Depeña, p. 5, Ins 5 - 35 & p. 6, Ins. 1 - 24.

⁴² Entex Exhibit 2, Direct Testimony of Debra Depeña, p. 7, Ins. 1 - 9. G.U.D No. 3666.

⁴³ GUD No. 3666. Finding of Fact No. 2.

⁴⁴ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 32, Ins. 15 - 26.

⁴⁵ Entex Exhibit No. 2, Direct Testimony of Debra Depeña, p. 7, Ins. 10 - 25.

and Small Commercial Rate Schedule No. SC-832-2, are attached as **Exhibit 10** and **Exhibit 11**, respectively. The Commission issued a final order in GUD No. 3706 that implemented the same rates approved by the City of Tyler. A copy of the order in GUD No. 3706 is attached as **Exhibit 12**.

The tariffs approved in 1985, followed essentially the same pattern as the prior ordinances. Copies of those tariffs, Rate Schedule R 981 - 2, for residential customers, and SC 981 - 2, for small commercial customers are attached as **Exhibit 13** and **Exhibit 14**, respectively. In 1990, the City of Tyler again approved new rate schedules which, again were essentially the same as the prior tariffs. Those tariffs, Rate Schedule R 1446-2, for residential customers, and SC 1446-2, for commercial customers, are attached as **Exhibit 15** and **Exhibit 16**, respectively. In 1994, the City of Tyler again approved new rate schedules which were the same style as the prior tariffs. Rate Schedule R 1758 - 2, for residential customers, and SC 1758 - 2, for commercial customers, are attached as **Exhibit 17** and **Exhibit 18**, respectively. The PGA approved by the City of Tyler in each residential and commercial tariff since 1982, while not identical, is very similar.

Finally, Entex's service in the Tyler IDS was subject to the curtailment priorities for gas utilities set out in Tex. R.R. Comm'n, *Relating to the Approval by the Commission of Curtailment Programs for Natural Gas Transported and Sold within the State of Texas*, Docket No. 489 (Gas Utils. Div. January 5, 1973) (Final Order) "Curtailment Order GUD No. 489."⁴⁶ That order set out the curtailment priorities applicable to utilities. Specifically, the following priorities were set out, in descending order:

- A. Deliveries for residences, hospitals, schools, churches, and other human needs customers.
- B. Deliveries of gas to small industrials and regular commercial loads (defined as those customers using less than 3,000 Mcf per day) and delivery of gas for use as pilot lights or accessory or auxiliary equipment essential to avoid serious damage to industrial plants.
- C. Large users of gas for fuel or as a raw material where an alternate cannot be used and operation and plant production would be curtailed or shut down completely when gas is curtailed.
- D. Large users of gas for boiler fuel or other fuel users where alternate fuels can be used. This category is not to be determined by whether or not a user actually installed alternate fuel facilities, but whether or not an alternate fuel "could" be used.

⁴⁶ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 27, Ins. 11 - 14.

- E. Interruptible sales made subject to interruption or curtailment at Seller's sole discretion under contracts or tariffs which provide an effect for the sale of such gas as Seller may be agreeable to selling and Buyer may be agreeable to buying from time to time.

Thus, Curtailment Order GUD No. 489, set out different curtailment priorities for different classes of customers. The first to be curtailed would be interruptible sales, and the last to be curtailed would be deliveries for residences, hospitals, schools, churches, and other human needs customers. A crucial aspect of each of the tariffs filed for Entex's various customers, and the central issue in this case, are the purchased gas adjustment clauses.

c. The Purchased Gas Adjustment Clause Generally

It is well settled that regulatory authorities in Texas do not have the jurisdiction to set the well-head cost of gas. The cost of gas, however, is the most significant expense for a gas utility, typically responsible for 70% or more of the full price to customers.⁴⁷ The parties in this case agree that gas costs are the most significant expense for a gas utility.⁴⁸ Gas costs may be recovered through an escalator clause, commonly referred to as a purchased gas adjustment clause — the PGA. A purchased gas adjustment clause is a portion of a gas utility's tariff, approved by the appropriate regulatory authority, that allows proper gas costs, or changes in gas costs, to be passed on to the customer without the necessity of a full blown utility rate case. The actual gas expenses flows through to the consumer's bill as gas costs change.⁴⁹ The PGA permits recovery of a utility's single largest expense on a timely basis without regulatory lag.⁵⁰ As noted by the City of Tyler, both the utility and the consumer are potential beneficiaries of the PGA. The benefit of a PGA clause to the utility and its stockholders is to prevent an unjustified loss when gas costs increase. On the other hand, a PGA clause benefits the consumer by keeping the utility from obtaining an unjustified windfall when gas costs decrease.⁵¹

A PGA is just one of several different escalator clauses that have been developed over the years. Adjustments clauses sometimes include items other than gas costs. There are adjustment clauses for expenses other than gas costs; a good example is the tax adjustment clause which allows a utility to flow

⁴⁷ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 4, 13 - 14.

⁴⁸ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 4, Ins 10 - 17.

⁴⁹ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 4, Ins 10 - 27 & p. 5, Ins 1 - 2.

⁵⁰ Entex Exhibit 3, Direct Testimony of Joe N. McClendon, p. 6, Ins. 14 - 16.

⁵¹ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 5, Ins. 17 - 21.

through to its customers any new or increased taxes.⁵² The PGA clause, however, is limited to **gas costs**. The Austin Court of Appeals has explained that a PGA is an automatic escalator mechanism devised by utility regulators to deal with rapid fluctuations in the cost of natural gas and it operates to increase or decrease the revenue of a gas company by the amount of the increased, or decreased, costs of gas charged the gas company by its suppliers.⁵³

Automatic adjustment clauses have evolved over the years to include expenses other than traditional gas costs. Automatic adjustment clauses have been used throughout the United States to allow the pass through of all types of expenses, including interest expenses paid for prepaid gas costs, and deferred gas costs, lost and unaccounted for gas or line losses, take-or-pay payments, minimum bill charges, and certain operation and maintenance expenses. Some states have developed revenue requirement clauses, plant based adjustments, and earnings based adjustments to protect a utility's rate of return. As an overview, Mr. Fowler states that it would be fair to say that automatic adjustment clauses have been used in many different ways when the regulator saw specific costs that were volatile and justified relief without the necessity of numerous complete rate case proceedings.⁵⁴

Entex witnesses explained that the PGA has been expanded to allow recovery of other costs, such as transportation and storage costs. The FERC Uniform System of Accounts requires gas costs to be recorded in the 800 series of accounts. These accounts capture more than the mere cost of the gas molecules and include the cost of getting the gas to the city gate. The underlying purpose of the PGA clause has, however, remained the same, in that it is designed to more timely match revenues with variable expenses.⁵⁵ For over 20 years, all of the rate schedules that Entex has had on file with the Commission for service within the municipal and environs areas, have included a PGA provision.⁵⁶

d. The Gas Supply

Prior to November 1992, Entex's primary source of gas supply for resale to the Tyler IDS residential and commercial customer classes was United Gas Pipeline Company. The Entex system serving

⁵² Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 6 Ins. 8 - 12.

⁵³ *Southern Union Gas Company v. Railroad Commission of Texas*, 692 S.W.2d 137, 193 (Tex. App. — Austin 1985). Cited by witnesses for the City of Tyler and Entex: Tyler Exhibit No. 1, Direct Testimony of G. William Fowler, p. 5, Ins. 5 - 15; Entex Exhibit 3, Direct Testimony of Joe N. McClendon, p. 6, Ins. 10 - 16.

⁵⁴ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 7, Ins. 6 - 18.

⁵⁵ Entex Exhibit 3, Direct Testimony of Joe N. McClendon, p. 6, Ins. 16 - 20.

⁵⁶ Entex Exhibit 2, Direct Testimony of Debra DePeña, p. 4, Ins. 12 -14.

Tyler was connected to two major pipelines, Lone Star and United Gas Pipe Line,⁵⁷ and Entex also acquired gas from Lone Star Pipeline and from United Texas Transmission Company.⁵⁸ At the time the 1982 tariff was approved, Entex acquired gas from Natural Gas Pipeline Co. of America for its interruptible gas supply associated with two large-volume customers.⁵⁹ Effective December 31, 1989, Entex eliminated United Gas Pipeline Company's merchant function and obtained gas supply from Arkla Energy Marketing Company and BayTech Operating, Inc. Entex, however, still relied on United Gas Pipeline Company for transportation of gas for delivery to the Tyler IDS.⁶⁰

Entex entered into two gas supply contracts in 1992, one with TXO and one with TGM. The TXO contract was used to secure gas supplies purchased for all residential and small commercial customers in the Tyler IDS. The TGM contract secured a supply of gas that was purchased for specific customers.⁶¹ TXO and TGM were marketing affiliates of Delhi. Delhi was an intrastate gas pipeline, and an established natural gas merchant, engaged in the purchasing, gathering, processing, transportation, and marketing of natural gas.⁶² TXO and TGM were engaged in the purchase and sale of natural gas.⁶³ The gas purchased from TXO was delivered through Delhi Gas Pipeline.⁶⁴

The TXO contract was executed on May 12, 1992.⁶⁵ That document was signed by R.G. Bohall, on behalf of Entex and Dave Johnson, on behalf of TXO Gas Marketing Corporation ("TXO Corp."). The second contract was between Entex and Texas GasMark, Inc. ("TGM"). The TGM contract was

⁵⁷ Tyler Exhibit 2, Direct Testimony of Donald W. Niemiec, p. 5, lns. 19 - 20.

⁵⁸ Entex Exhibit 5, Direct Testimony of Bruce Coogler, 6 lns. 12 - 14. *See also, City of Tyler's Written Closing Statement and Initial Brief*, p. 3.

⁵⁹ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 14, lns. 21 - 23.

⁶⁰ Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 7, lns. 3 - 16.

⁶¹ Entex Exhibit 1, Direct Testimony of Charles Harder, p. 5, lns. 17 - 19. Entex Exhibit 8, Direct Testimony of Rodney Pennington, p. 4, lns. 12 - 3. Tyler Exhibit 2, Direct Testimony of Donald W. Niemiec, p. 7, lns. 25 - 26 & p. 8, lns. 1 - 10.

⁶² Entex Exhibit 6, Direct Testimony of David Johnson, p. 4, lns. 7 - 8.

⁶³ Entex Exhibit 6, Direct Testimony of David Johnson, p. 2, lns. 20 - 23.

⁶⁴ Entex Exhibit 8, Direct Testimony of William Rodney Pennington, p. 4 lns. 14 - 15.

⁶⁵ Tyler Exhibit 1, Direct Testimony of G. William Fowler, Exhibit GWF - 9, p. 18; Entex Exhibit 5, Direct Testimony of Bruce Coogler, Exhibit BC - 6, p. 18.

executed on May 12, 1992.⁶⁶ That document was also signed by R.G. Bohall, on behalf of Entex, and Dave Johnson, on behalf of Texas Gas Marketing Incorporated (“Texas GasMark Inc.”).⁶⁷ R.G. Bohall was Vice-President at Entex and Dave Johnson was Vice-President at Texas GasMark, Inc. and TXO Corp. These facts are summarized in a table attached as **Exhibit 19**, which also compares key provisions of the two contracts. A key difference was the price of gas: Natural gas purchased pursuant to the TGM contract was, on the face of the contract, around \$1.20 per Mcf less than the gas acquired through the TXO contract. The City of Tyler was not provided a copy of those contracts during the Review Period.

At the time the contracts were entered into, twelve customers were excluded from the TXO contract. Nine of these customers were included in the TGM Contract and were described as general service customers.⁶⁸ These nine customers will be described as the TGM Exhibit B Customers. The exact nature of these customers’ gas use is a subject of dispute in this case and the controversy regarding their status will be discussed below. Table 1 provides a list of the TGM Exhibit B Customers, as that list was composed in 1992.

Table 1
Exhibit B List

Brookshire Grocery
Carrier Air Conditioning
Flowers Baking
Jewell Concrete Products
Medical Center Hospital
Mother Frances Hospital – Laundry
Mother Frances Hospital
RexHide
Vesuvius USA

The nine select customers did not have back-up fuel capability.⁶⁹ Throughout the Review Period the

⁶⁶ Tyler Exhibit 1, Direct Testimony of G. William Fowler, Exhibit GWF - 8, p. 14; Entex Exhibit 5, Direct Testimony of Bruce Coogler, Exhibit BC - 8, p. 17.

⁶⁷ Tr. Vol. III, p. 55, lns. 7 - 13.

⁶⁸ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 22, ln. 6.

⁶⁹ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 27, ln. 21 - 22.

customers whose natural gas service was provided through gas acquired by Entex pursuant to the TGM contract changed. Some customers were removed and others were added.⁷⁰

In addition, throughout the Review Period, service was available from Entex to every TGM Exhibit B Customer pursuant to two different contracts; thus, Entex had two contracts applicable to TGM Exhibit B Customers. Entex also filed tariffs for rates applicable to those contracts.⁷¹ First, the TGM Exhibit B Customers would negotiate with Entex a “Complementary Contract” for interruptible service.⁷² This was the primary contract between Entex and that customer. Entex acquired the gas supply for that contract customers through the TGM contract. Entex filed tariffs with the City of Tyler that reflected the rates in the Complementary Contracts. The tariffs that governed the rates under that contract were considered by Entex to be interruptible tariffs.⁷³ Second, the TGM Exhibit B Customers were also offered a different contract (Backup Contract) and were able to acquire service under an entirely different tariff. That tariff was Tariff 590. All TGM Exhibit B Customers entered into a Backup Contract with Entex. The Backup Contract was intended to provide firm service in the event service pursuant to the customer’s Complementary Contract was interrupted.⁷⁴ The fact that the TGM Exhibit B Customer, subject to a Complementary Contract, also had a Backup Contract, was not disclosed on either tariff.

In the event of a curtailment, those customers classified by Entex as “interruptible” contract customers would be the first to be curtailed pursuant Curtailment Order GUD No. 489. By entering into a firm service contract, the Backup Contract, governed by Tariff 590, the customer would move to a class less likely to be curtailed.⁷⁵ Natural gas for service under Tariff 590 would be acquired by Entex through the TXO contract. The customers holding a Tariff 590 contract with Entex would not pay under that contract until service was rendered pursuant to that contract, and they did not pay a reservation fee, or a standby fee, for that backup service.⁷⁶

As an example, Mother Frances Hospital, Mother Frances Hospital - Laundry, and the Medical Center Hospital were TGM Exhibit B Customers. Mother Frances Hospital, Mother Frances Hospital -

⁷⁰ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 27, ln. 20.

⁷¹ Tr. Vol. II, p. 131 lns. 1 - 21.

⁷² Entex Exhibit 4, Direct Testimony of Joe N. McClendon, Exhibit JNM - 1, 51 - 55 (Example of a Complementary Contract).

⁷³ Entex Exhibit 10, Rebuttal Testimony of DePeña p. 10, lns. 8 - 33, p. 11, lns. 1 - 18.

⁷⁴ Tr. Vol. II, p. 117, lns. 8 - 19; Entex Exhibit 10, Rebuttal Testimony of DePeña, p. 11, 14 - 18.

⁷⁵ *See*, Entex Exhibit 2, Direct Testimony of DePeña, pp. 17 - 20.

⁷⁶ Tr. Vol. III, p. 39, lns. 9 - 16.

Laundry, and the Medical Center Hospital had negotiated Complementary Contracts, which were the primary interruptible service contract for those customer.⁷⁷ Entex acquired gas supplies for the medical centers pursuant to its contract with TGM. The TGM gas costs were passed through to Mother Frances Hospital, Mother Frances Hospital - Laundry, and the Medical Center Hospital. The hospitals also negotiated a Backup Contract, governed by Tariff 590. In the event that service under the Complementary Contract was interrupted, the hospitals would be able to acquire natural gas service pursuant to the firm Backup Contract, as reflected in Tariff 590, which guarantees firm natural gas service.⁷⁸ If required, Entex would acquire backup gas pursuant to its contract with TXO, and only at that point would those costs be passed through to the hospital.

Entex matched the costs of gas supply with the customers for whom the gas was purchased.⁷⁹ Instead of summing the costs of all of the gas supplies, and calculating a pooled weighted average cost of gas ($WACOG_{\text{Pooled}}$) Entex engaged in a process it referred to alternatively as “streaming,” matching, or allocation of gas costs. Thus, two different weighted average costs of gas were calculated for the Tyler IDS. Entex calculated a weighted average cost of gas for all customers whose natural gas was acquired by Entex through the TXO contract ($WACOG_{\text{TXO}}$). Entex calculated a different weighted average cost of gas for those customers for whom Entex acquired gas pursuant to the TGM contract ($WACOG_{\text{TGM}}$). Entex maintained at the hearing that streaming, or matching, of gas costs is a widespread practice within its various service areas. The $WACOG_{\text{TXO}}$, which was the cost of gas paid by the residential and commercial customers of the Tyler IDS was higher than the $WACOG_{\text{TGM}}$ paid by the TGM Exhibit B Customers.

V. The Allegations of the City of Tyler and the Burden of Proof

Against this factual background the City of Tyler has raised several allegations. The principal allegations center around alleged price manipulation.⁸⁰ Although a PGA is useful, the City of Tyler points out that the PGA may be manipulated. The utility may simply fail to act as a prudent, responsible purchaser. Without conscientious management direction and attention, it is all too easy for a utility that expects to simply flow-through 100% of its gas cost expenses not to act as a good purchaser. The utility may fail to prudently administer a gas purchase contract, such as by failing to timely exercise a price redetermination option. The utility may include non-gas cost expense items in gas costs and may pass through costs that are not, in fact, gas costs. A utility may enter into supplemental arrangements where the purchasing utility obtains additional benefits from the supplier, benefits that may not necessarily be flowed

⁷⁷ Entex Exhibit 2, Direct Testimony of DePeña, p. 18, lns. 14 - 15.

⁷⁸ Entex Exhibit 2, Direct Testimony of DePeña, p. 19, lns. 10 - 22.

⁷⁹ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 6, ln. 3 - 4.

⁸⁰ City of Tyler’s Written Closing Statement, p. 1.

through to the customers paying the higher gas costs. These can include agreements for lower-priced gas in some packages in exchange for higher-priced gas in other packages. Finally, a utility may provide more favorable terms to purchases from affiliates than required by the market.⁸¹ The City of Tyler has raised claims that range from blatant violations of the filed tariffs, filing false and misleading tariffs, to issues related to the prudence of Entex's gas management decisions.

The City of Tyler alleges that Entex discriminated between classes of customers and among classes of customers. A key component of this claim is that there was no distinction between the service and gas supplies that supported service to "interruptible customers" and the service and gas supplies that supported service to firm customers. Both groups of customers, firm and "interruptible," had available the same supply of gas. The "interruptible" customers were simply furnished a huge discount.

The City of Tyler alleges that Entex violated its tariffs by not including all gas supplies, acquired to serve its customers, to calculate the weighted average cost of gas for the Tyler IDS. Specifically, the City of Tyler alleged that there is nothing in the Entex tariffs that allows for the segregation of gas costs. The weighted average cost of gas calculation for all Tyler IDS should be based upon a pooling of gas costs — WACOG_{Pooled}. Another violation of the tariff alleged by the City of Tyler is that Entex improperly passed through non-gas costs through the PGA. Specifically, the City of Tyler alleges that Entex passed through over five million dollars in capital improvements made by Delhi. Related to that claim, Entex improperly acquired a capital asset that was funded by revenues recovered through the PGA.

The City of Tyler also raised several issues related to the prudence of Entex's gas management practices during the review period. The City of Tyler argued that Entex paid a price for natural gas supplies under the TXO contract that were simply too high. The City of Tyler maintains that Entex acted imprudently by acquiring high priced gas supplies for residential and commercial customers. There was, the City of Tyler alleges, no reason for Entex to pay TXO a rate of ETI + \$1.29, and then pass that cost through to its residential and commercial customers through the PGA. The City of Tyler argues that passing through that price was not just, reasonable, or necessary. The City of Tyler alleges that by purchasing higher priced gas for residential and commercial customers, those customers were overcharged approximately \$39,000,000. The City of Tyler also argues that a prudent manager would have pooled the cost of gas — WACOG_{Pooled}.

The City of Tyler alleges that Entex filed false, misleading or improper tariffs to hide the discriminatory nature Entex's pricing structure from the City of Tyler. Furthermore, the City of Tyler alleges that Entex violated its tariffs by filing reports that were false, or misleading. The TGM Exhibit B Customers, were not "interruptible" customers. The tariffs filed for these customers were simply false because they were not interruptible customers, nor did they receive an interruptible supply. The City of

⁸¹ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 9, Ins. 19 - 28, p. 10, Ins. 1 - 7.

Tyler raises issues in this context of fraud and conspiracy.

Additionally, the City of Tyler argues that affiliate transactions afforded Entex another opportunity to segregate low cost TGM gas supplies from the system WACOG. Furthermore, the City of Tyler alleges that Entex violated the affiliate transactions standard in its transactions with its affiliate.

The claims raised by the City of Tyler raise an issue regarding the appropriate burden of proof. The City of Tyler acknowledges that it must bear the burden of proof on its allegations of fraud and conspiracy.⁸² It is also well settled that the burden of proving unlawful discrimination rests upon the party asserting the claim.⁸³ The City of Tyler argued that the burden of proof regarding the reasonableness and necessity of Entex's gas purchases — the prudence claims — rests with the utility. Entex, on the other hand, argued that the burden of proof lies with the City of Tyler.

The City of Tyler argued that it is well established that the utility has the burden of proof when it comes to rate setting and *that* burden is set out in the Texas Utilities Code.⁸⁴ Entex argued that neither of the circumstances set out in relevant provisions of the Texas Utilities Code apply in this case. First, Entex was not proposing a rate change and, second, there is no proposal that Entex's current rates be changed.

The Examiners ruled in **Examiners' Letter No. 14**, that Entex had the burden of proof on issues related to the prudence of its gas purchase practices. In the context of a rate proceeding or reconciliation proceeding, such as *Tex. R.R. Comm'n, TXU Gas Distribution — Transmission Gas Cost Review, Docket No. 9233* (Gas Utils. Div. April 23, 2004) (Final Order) "GUD No. 9233," the utility bears the burden of proof. GUD No. 9233 emanated from a rate making proceeding in which the reconciliation proceeding was intended, in part, to meet the requirements of the Commission's gas cost recovery rules.⁸⁵ The fact that this case originates as a complaint, or other regulatory inquiry into the practices of Entex, should not result in a shift of the burden of proof. Nevertheless, because this case more closely resembles a complaint case instead of a rate proceeding, the Examiners concluded that the City of Tyler carried the burden of coming forward with its case. Once the City of Tyler has made its case for relief, the burden shifted to Entex to make an affirmative defense.⁸⁶

⁸² *City of Tyler's Brief on the Burden of Proof*, May, 6, 2004, , p. 2.

⁸³ *Ford v. Rio Grande Valle Gas Co.*, 174 S.W.2d 479, 480 (Tex. 1943); *Amtel Communications v. Pub. Util. Comm'n*, 687 S.W.2d 95 (Tex. App. — Austin, 1985).

⁸⁴ TEX. UTIL. CODE ANN. § 104.008.

⁸⁵ 16 TEX. ADMIN. CODE § 7.5519.

⁸⁶ *See Tex. R. Civ. Pro. 94; see also, Re Public Service Company of New Hampshire*, 29 PUR 4th 242 (1979).

VI. Was the Gas Cost Pricing Scheme Discriminatory?

a. The Statutory Standard

The City of Tyler argues that the rates charged were discriminatory pursuant to two statutory provisions of the Texas Utilities Code. Section 104.003 provides that a rate may not be “unreasonably preferential, prejudicial, or discriminatory but must be sufficient, equitable, and consistent in application to each class of customer.”⁸⁷ In addition, section 104.004 precludes a utility from granting an unreasonable preference or advantage concerning rates or services to a person in a classification.⁸⁸ Further, a utility may not subject a person in a classification to an unreasonable prejudice or disadvantage concerning rates or services.⁸⁹ Finally, a utility may not establish or maintain an unreasonable difference concerning rates of services between localities or between classes of customers.⁹⁰

The burden of proving unlawful discrimination rests upon the party asserting the claim.⁹¹ Mere inequality is not unlawful discrimination.⁹² The prohibition against unlawful discrimination allows a range of unequal treatment based upon a rule of reasonableness. The different treatment, however, must be founded upon a substantial and reasonable ground of distinction between favored and disfavored classes of people.⁹³ Thus, in this case, the City of Tyler must establish that the same level of service was provided to certain members of the same class of customer at a preferential price.

b. The Level of Service Provided.

i. The Arguments of the parties.

The City of Tyler argues that in order to ascertain the level of service provided, one must look to the underlying contracts that supplied the natural gas ultimately consumed by the customer. In other words, the level of service is defined by the contract between Entex and the supplier of gas. The City of Tyler

⁸⁷ TEX. UTIL. CODE ANN. § 104.003(a).

⁸⁸ TEX. UTIL. CODE ANN. § 104.004(1).

⁸⁹ TEX. UTIL. CODE ANN. § 104.004(2).

⁹⁰ TEX. UTIL. CODE ANN. § 104.004(3).

⁹¹ *See, Ford v. Rio Grande Valley Gas Co.*, 174 S.W.2d 479, 480 (Tex. 1943); *Amtel Communications v. Pub. Util. Comm'n*, 687 S.W.2d 95 (Tex. App. — Austin, 1985).

⁹² *Id.*

⁹³ *United Gas Corp. v. Shepard Laundries Co.*, 189 S.W.2d 485 (1945).

argues that there was no meaningful distinction between the gas procured pursuant to the TGM contract and the TXO contract. The City of Tyler argues that both the TXO and TGM contract were firm supply contracts⁹⁴ and that there was no meaningful distinction between the gas supplied under the TXO contract and the gas supplied under the TGM contract.⁹⁵ As a result, Mr. Fowler argues that the TGM Exhibit B Customers did not receive interruptible service.⁹⁶

Together, the TGM and the TXO contracts supplied firm gas service to Entex's Tyler IDS. Gas supplied under the contracts was commingled and delivered to all customers — high priority residential and commercial customers, and the TGM Exhibit B Customers. The alleged interruptible customers are downstream of the city gates and on the same distribution system as the residential customers. The City of Tyler points out that Entex has admitted those customers have not been curtailed. An indication that both contracts were for firm supplies was the fact gas nominations and gas purchase confirmations clearly establish that the type of gas services was firm.⁹⁷

The testimony of Mr. Fowler indicates that, at some point throughout the litigation in this proceeding, Entex argued that the service under the TGM contract was not firm.⁹⁸ Although Entex appears to have abandoned that position, Entex argues that the two agreements provide “vastly different levels of firm service.”⁹⁹ Entex argues that the two contracts reflected two totally different levels of service. The TXO contract was intended to serve the combined residential and commercial load. The TGM contract was intended to serve the large volume industrial load.¹⁰⁰ Mr. Coogler, who assisted in the negotiations of the TXO contract,¹⁰¹ testified that the TXO contract required TXO to supply firm gas to Entex for resale to Tyler IDS residential and commercial customers under their respective rate schedules approved by the City. The TXO contract guaranteed a firm supply of the full requirements of the Tyler IDS residential and small commercial customers classes.

⁹⁴ Tyler Exhibit 1, Direct Testimony of William G. Fowler, p. 18, Ins. 12 - 19.

⁹⁵ Tyler Exhibit 1, Direct Testimony of William G. Fowler, p. 26 p. 1 - 4.

⁹⁶ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 26, In. 7.

⁹⁷ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 26, Ins. 26 - 27 & Ins. 1 - 4.

⁹⁸ Tyler Exhibit 8, Rebuttal Testimony of G. William Fowler, p. 4, Ins. 16 - 19; Tyler Exhibit 18, p. 140.

⁹⁹ Entex Exhibit 8, Direct Testimony of William Rodney Pennington, p. 50. Initial Post-Hearing Brief of CenterPoint Energy Entex, p. 30.

¹⁰⁰ Entex Exhibit 6, Direct Testimony of David Johnson, p. 5, Ins. 1 - 9.

¹⁰¹ Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 12, In. 18.

The TXO contract was intended to meet both the peak and base load requirements of residential and commercial Tyler IDS. Entex calculated its peak demand based upon the peak gas flow supplied to residential and commercial customer classes on December 23, 1989, which was the coldest day with the highest demand for those customer classes in Tyler's recent history. Based upon these calculations, Entex estimated a peak day demand of 61,830 MMBtu/d and a peak hour demand equal to 75,190 MMBtu/d. The TXO contract guaranteed Entex the level of firm gas supply required to meet this peak demand. Specifically, the TXO contract required TXO to provide Entex's total gas requirements up to a daily rate of 50,000 MMBtu/d and an instantaneous maximum flow rate of 65,000 MMBtu/d and granted Entex the option to purchase additional quantities if necessary. This contractual guarantee is set forth in Section 3 of the TXO contract.¹⁰²

Additionally, the TXO agreement was backed by a guaranty agreement with Delhi. According to David Johnson, the purpose of the guaranty agreement was to provide specific assurance that, should TXO fail to perform for any reason, the performance would be backed and unconditionally guaranteed by Delhi Gas Pipeline, which had substantial assets.¹⁰³ The Guaranty Agreement with Delhi, TXO's regulated affiliate, was a means of obtaining a quick remedy at the Commission in the event that any dispute arose regarding the gas to be supplied under the TXO contract.¹⁰⁴ This agreement is significant in that it provided an added measure of supply reliability that is not normally present when contracting for gas supply with an unregulated gas marketer.¹⁰⁵

Other important aspects of the TXO contract were the provisions regarding the quality of gas to be provided, Entex had the right to refuse delivery of sub-standard gas,¹⁰⁶ and an agreement between Entex and TXO that provided supply and reliability assurances through TXO's agreement to provide facilities sufficient to deliver gas to multiple points of delivery. These multiple points of delivery enhanced the reliability of supply in the event of a line rupture or other event.¹⁰⁷ Finally, the TXO contract provided a price cap that limited the annual price paid for gas supplied under the contract to 95% of Entex's weighted average cost of gas ("WACOG") in the surrounding East Texas region and guaranteed that the gas purchased under the TXO contract is priced lower than that in the surrounding East Texas regions

¹⁰² Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 13, lns. 1 - 12.

¹⁰³ Entex Exhibit 6, Direct Testimony of David Johnson, p. 5, lns. 14 - 16.

¹⁰⁴ Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 14, lns. 11 - 22.

¹⁰⁵ Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 13, lns. 20 - 24 and p. 14, ln. 1 - 2.

¹⁰⁶ Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 13, lns. 13 - 15.

¹⁰⁷ Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 13, lns. 16 - 19.

served by Entex.¹⁰⁸

In contrast, Entex entered into the TGM contract to serve the larger volume customers listed in Exhibit B to the TGM contract, the TGM Exhibit B Customers.¹⁰⁹ The demand requirements of the customers served by the TGM contract correspond to the larger volume customer demand requirements set forth in, what Entex alleges, are the city-approved rate schedules filed with the city pursuant to GURA and the city's franchise agreement.¹¹⁰

The customers eligible for service from Entex with natural gas supplied by TGM was not static. In other words, although TGM Exhibit B was not actually changed, customers in the Tyler IDS who could be served by TGM gas changed. Entex witnesses testified that the TGM contract supplied gas to customers meeting certain demand characteristics. During the Review Period, as additional entities qualified for complementary gas sales contract service, Entex would provide those customers with the TGM gas supply. Those customers could have been existing sales customers whose volumes increased over time or could have been businesses that were new to the Tyler area. Likewise, if a customer either went out of business or its annual volumes declined far below the Rate Schedule's stated applicable volume, a customer could be removed from the TGM supply. By the end of the Review Period, there were six customers receiving the TGM gas supply that were not on the original Exhibit B to the TGM contract. Additionally, one customer that was listed on the original Exhibit B was not on the list at the end of the Review Period.¹¹¹ Finally, there was no guaranty agreement by Delhi under the TGM contract.¹¹²

Mr. Coogler testified that the gas supply for large volume industrial customers would cost less than gas supply for residential and commercial customers. The cost of supply is largely driven by load factor. Because of the extreme swings in residential and commercial gas, such gas has a very low load factor. In essence, a pipeline must build its facilities and reserve quantities of gas to meet peak demand, but will generally sell less than 10 - 12% of that peak level for residential and commercial purposes on an average-day-basis for the year. By contrast, large volume industrial load remains fairly constant. Thus, there is far less risk and far less incremental cost associated with supplying industrial load. Consequently, pricing for gas used to supply large volume industrial demand is significantly less than that for residential and small commercial customers. Comparing the average price for natural gas supplied to the large volume industrial class and the residential and commercial classes demonstrates that industrial gas supply was significantly

¹⁰⁸ Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 14, lns. 3 - 9.

¹⁰⁹ Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 17, lns. 6 - 10.

¹¹⁰ Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 17, lns. 12 - 17.

¹¹¹ Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 18, lns. 9 - 21.

¹¹² Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 19, lns. 5 - 8.

less than either residential or commercial gas supply in Texas during the time period 1998 - 2002.

Entex established that it could interrupt the flow of gas taken under the TGM contract if it felt it necessary.¹¹³ Entex maintained that the customers that received TGM gas were interruptible customers, despite the fact that they were never interrupted. The fact that these customers took service under an interruptible tariff did not mean that Entex was obligated to interrupt them. It just means that, in the event of a shortage, these customers recognized that their supply was subject to interruption. Gas supplied under an interruptible tariff carries a lower priority than “firm” gas in the event that curtailment becomes necessary. This remains true whether the actual supply arrangement is for “firm” or “interruptible” gas. The tariff describes the relationship between Entex and its customers, not the agreement between the supplier and Entex’s customers.¹¹⁴

¹¹³ Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 21, Ins. 11 - 14.

¹¹⁴ Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 21, Ins. 16 - 24.

ii. Examiners' Conclusion and Recommendation.

The Examiners agree that the supply under the TGM contract was firm. This fact does not appear to be in dispute. The Examiners agree with Entex that the service provided by the TGM contract is different from service provided under the TXO contract. The key difference is the level of risk that the underlying supply may be interrupted. In theory, gas supplied under the TGM contract could be interrupted, whereas gas supplied under the TXO contract was not interruptible. Simply stated, the TGM Exhibit B Customers had a higher risk of interruption. This position was repeated by Entex's witnesses on several occasions. That difference in the underlying risk accounted for the difference in price between the two contracts.

The Examiners do not agree that, because both underlying gas supply contracts provided firm service, the TGM Exhibit B Customers were not interruptible customers. The service provided to the ultimate consumer is not exclusively defined by the nature of the underlying gas supply contract between Entex and its supplier. The nature of the service provided, whether it is interruptible or firm, is defined by contract between Entex and its customer, and the tariff that is filed reflecting the contracted rate. Of course, if the underlying contract between Entex and its supplier is interruptible, that could enlighten the evaluation of the contract between Entex and its customers. Nevertheless, the fundamental nature of the customer, as either interruptible or firm, is defined by Entex's relationship to that customer by the tariff, the statute, and Commission rules.

Using that standard, all of the service provided to the customers must be evaluated, before a decision can be made as to whether a particular customer is an interruptible customer. The TGM Exhibit B Customers all had an additional contract with Entex. That contract entitled the customer to take firm gas if gas service under the interruptible Complementary Contract was not provided. The rates under that contract are reflected in Tariff 590. The combined package, offered to TGM Exhibit B Customers removed any risk differential that existed between the TGM Exhibit B customers and all other Entex customers. Furthermore, the risk shield was provided for free — until the TGM Exhibit B Customer decided to exercise the option to take gas under the provisions of Tariff 590 and accompanying contract. The net effect is that those customers were not interruptible customers. They received the same level service as the other customers in the Tyler IDS. Thus, from the perspective of risk, the TGM Exhibit B Customers received the same level of firm service. Load requirements may be distinguishable and will be discussed in the context of class of customer.

c. Class of Customers.

i. Arguments of the Parties.

A price differential between customer classes might be justified if the classes of customer are

different. The City of Tyler points out that several of the TGM Exhibit B Customers were human needs customers and, in fact, high priority customers.¹¹⁵ Indeed, the City of Tyler argues, that there was no justification or underlying reason for segregation of gas costs to be charged the different classes of customers. Entex, in an apparently random fashion, entered into so-called interruptible Complementary Contracts, with customers not listed on the original TGM Exhibit B. Those customers include Moore Asphalt, Inc., Kiepersol, Ranch, Inc., Bonar Packaging, Inc., and Aratex Services, Inc. The result was that any presumed distinction between customers originally on TGM Exhibit B was further blurred. It conclusively establishes that Entex did not perceive any meaningful differences among them. In addition, Mr. Fowler notes that as a group, those customers did not have back-up fuel capability.¹¹⁶

Entex appears to draw a distinction between “system supply customers” and other customers served on the Tyler IDS, who were either industrial customers, or a TGM Exhibit B Customer. System supply customers are residential and commercial customers whose gas supply, like the character of the service to residential and commercial customers, is firm.¹¹⁷ Mr. Harder stated that for all customer classes served from system supply, the cost of gas purchased for resale would have been the same.¹¹⁸ The other distinction made by Entex is the customer load requirement. A considerable amount of testimony was presented by Entex to establish that the customer load requirement of the TGM Exhibit B Customers was substantially different than the other residential and commercial customers. The essence of that testimony is best summarized by Exhibit BC-1 attached to Mr. Coogler’s testimony, and attached as **Exhibit 20**. As is evident from that exhibit, and the testimony presented by Entex’s witnesses, the base load requirements of those customers, identified as interruptible, remains relatively constant below 100,000 Mcf throughout the entire review period. On the other hand, the residential customer load requirement is subject to wide swings, from less than 100,000 Mcf at times to peaks as high as 700,000 Mcf.

ii. Examiners’ Conclusions and Recommendation

The discriminatory claims made by the City of Tyler raise three distinct areas of concern. First, is the question of discrimination between the general class of residential and commercial customers, and the TGM Exhibit B Customers. Second, there is the question of discrimination between the commercial customers generally, and the TGM Exhibit B Customers. Third, there is the question of the discrimination within two classifications used by Entex: Class 3 and Class 5.

¹¹⁵ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 26, lns. 17 - 18 & p. 27, lns. 7 - 14.

¹¹⁶ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 27, lns. 21 - 22.

¹¹⁷ Entex Exhibit 1, Direct Testimony of Charles J. Harder, p. 9.

¹¹⁸ Entex Exhibit 1, Direct Testimony of Charles J. Harder, p. 12, lns. 18 - 19.

These issues are summarized as follows:

- Residential and Commercial compared to TGM Exhibit B Customers
- Commercial compared to TGM Exhibit B Customers
- Class 3 and Class 5 compared to TGM Exhibit B Customers

First, as a group, the TGM Exhibit B Customers' load characteristics appears to provide some distinction between the combined load characteristics of residential and commercial customers. Exhibit BC - 1, attached to the testimony of Bruce Coogler, and attached hereto as **Exhibit 20**, clearly reveals that distinction. Nevertheless, the Examiners note that peaks within the TGM Exhibit B Customers follow the peaks of the combined residential and commercial class.

Second, the record in this case does not reveal that there was any meaningful distinction between the general commercial customers and the TGM Exhibit B Customers. Those commercial customers had rates that were governed by the following tariffs during the review period: SC-1446-2, SC-981-2, SC-1758-2, SC-982-2. There appears to be a degree of consumption, under the 100,000 Mcf monthly amount, that is not purchased by the TGM Exhibit B Customers. This is expressed in **Exhibit 21** as the area shaded in green.¹¹⁹ There is no reason to treat customers in that consumption area differently from customers within the TGM Exhibit B Customer group.

Finally, Entex's classification, or distinction, appears to be inconsistent. Ms. DePeña testified that all TGM Exhibit B Customers were eligible for service under Tariff 590, if they chose to contract for that service. In fact, all TGM Exhibit B Customers had Backup Contracts. Mr. Harder testified that the TXO contract contemplated the purchase of gas supplies for resale to Entex's residential, commercial, and small industrial customers in and near the City of Tyler.¹²⁰ The rate schedules that corresponded to those customer classes were identified by Mr. Harder as follows: "R-1758-2, SC-1758-2, R-981-E, SC-981-E, 588 and **590**."¹²¹ In other words, as defined by Entex, the class of customers identified as "residential, commercial, and small industrial customers" were governed by a group of tariffs, that included Tariff 590. By Entex's own definition, therefore, the interruptible customers — who all had a Backup Contract that made them eligible for service under Tariff 590 — were part of that class of customers, identified by Entex as "residential, commercial, and small industrial."

¹¹⁹ Exhibit 21, is a copy of Mr. Coogler's Exhibit BC-1, attached as Exhibit 20, modified by the Examiners.

¹²⁰ Entex Exhibit 9, Rebuttal Testimony of Charles J. Harder, p. 5, Ins. 19 - 21.

¹²¹ Entex Exhibit 9, Rebuttal Testimony of Charles J. Harder, p. 6, Ins. 1 - 4. (Emphasis added).

Third, the record reveals that there is no distinction between customers within two narrow classification. Class 3 and Class 5 customers consumed the same volume of gas. These classifications were based solely on volume. For example, a Class 3 customer is defined by Entex as a commercial end use customer using between 1800 Mcf and 200,000 Mcf in a year.¹²² Entex admits that within these two classifications, not all entities were offered the opportunity to purchase gas pursuant to a Complementary Contract. Significantly, not all Class 3 customers were offered the combined package of a Complementary Contract and a Backup Contract. Thus, all Class 3 and Class 5 customers, however, were not treated equally. Only some of the Class 3 customers were offered service under a Complementary Contract and the same was true of customers that were Class 5.¹²³

Entex's determination for eligibility for a Complementary Contract appears to be arbitrary. Ms. DePeña, testifying on behalf of Entex, indicated that eligibility was based on volume or economic need. When queried about how a customer became eligible for service under a Complementary Contract, she responded that if a customer is consuming a lot of gas, Entex might approach that customer. In other cases, a customer might approach Entex if it is having economic difficulty and ask "is there a way that they [the customer] can get a more economic supply of gas for their use in their facilities."¹²⁴

VII. The Tariffs and the Franchise Agreement: Is matching of gas costs authorized?

Entex maintains that the filed tariffs clearly demonstrated that gas costs were being matched or allocated, and that the City of Tyler approved the cost assignment methodology. A PGA clause is part of the utility's filed rate and requires regulatory approval prior to implementation.¹²⁵ Entex witnesses stated that for at least twenty years Entex's tariffs have included a PGA clause. Additionally, witnesses for Entex pointed out that it has historically, both for the Tyler IDS and in other markets within Texas, matched particular customer classes having particular load profiles to specific sources of supply. According to Entex, this practice has been approved by both the City and the Commission. Prior to entering into the TGM contract, the TGM Exhibit B Customers had been served through supply contracts primarily with Surtex Gas Company and other companies. Entex witnesses testified that providing a separate source of supply for large volume industrial customers whose demand matched a certain load profile did not originate with the TGM contract. The TGM contract represented only a change in the source of supply, not a change in Entex's policy of matching customer load to supply.¹²⁶

¹²² Tr. Vol. VI, p. 84, lns. 21 - 22.

¹²³ Entex Exhibit 33, p. 2.

¹²⁴ Tr. Vol. VI, pp. 86 - 87.

¹²⁵ Entex Exhibit 3, Direct Testimony of Joe N. McClendon, p. 7, lns. 16 - 22, p. 8 ln. 1.

¹²⁶ Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 18, lns. 1 - 7.

The City of Tyler alleges two violations of the tariff's PGA provisions. First, the City of Tyler alleges that Entex incorrectly calculated its gas costs. The WACOG calculation should have included all of the gas supplies that Entex acquired for the Tyler IDS. As discussed above, Entex matched, or "streamed," gas costs to particular customers, or customer classes. The City of Tyler argues that this is a violation of the various tariffs filed with the regulatory authorities. Second, the City of Tyler also alleges that Entex violated the PGA tariff by including in the PGA the costs of capital improvements. At this juncture, consideration of compliance with the applicable tariff and franchise agreement is not an issue of the prudence of Entex's gas purchase practices. The issue is whether Entex charged the rate authorized by the tariff. If Entex did not comply with the tariff, the rates charged were not authorized.

Entex did not combine the cost of gas supplied to all customers when it calculated the PGA paid by residential and commercial customers. Instead, as already noted, Entex matched the cost of lower-priced gas purchased under a contract with TGM in 1992, to the TGM Exhibit B Customers.¹²⁷ It is the City of Tyler's position that the gas cost attributable to those customers should have been included as a part of the gas supply for residential and small commercial customers.¹²⁸ The City of Tyler argues that this practice violated the applicable franchise agreement and tariff. In support of its position, the City of Tyler raises two related arguments. First, there is a fundamental presumption that a PGA does not allow segregation of costs. Second, the City of Tyler maintains that there was no specific language in Entex's tariffs that allowed the segregation, or allocation of gas costs. A third point, raised by the City of Tyler, is that Entex failed to inform the regulatory authorities that it interpreted its tariff to allow Entex to match, or stream costs.

a. The fundamental presumption of the PGA

The City of Tyler argues that, contrary to Entex's assertions, the tariffs and franchise agreements that were in effect during the review period did not allow allocation, or matching of gas costs. Mr. Fowler, testified that a fundamental presumption underlying a PGA is that gas costs are not segregated; the presumption is that all purchases of gas are to be included in the WACOG calculation for the entire Tyler IDS. In support of his position, Mr. Fowler traced the history of PGA clauses in general, and in Texas in particular. Mr. Fowler concluded that it would be contrary to the fundamental basis of a PGA clause to allow a utility to manipulate gas costs by selectively including or excluding individual gas purchases.¹²⁹

Entex argues that the fundamental presumption alleged by the City of Tyler is incorrect. Entex

¹²⁷ Entex Exhibit 1, Direct Testimony of Charles J. Harder, p. 4, ln. 22 & p. 5, lns. 1 - 3.

¹²⁸ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 28, lns. 3 - 11.

¹²⁹ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 6, lns. 8 - 20.

argues that nothing in GURA, or any other source supports this presumption. Instead, the allocation of a utility's gas costs under a PGA clause is determined by the express language of the PGA clause.¹³⁰ PGA language may differ from utility to utility. If the regulatory authority intended for all gas costs to be included in the WACOG calculation, the regulatory authority could require the utility to include language in the utility's PGA clause to state that the cost of all gas purchased for resale to all customer classes is to be included in the PGA calculation for the customer class.¹³¹ On the other hand, if the regulatory authority intended for gas cost purchased for a single class of customers to be included in the PGA for that class of customers, the regulatory authority would have used the language found in Entex's PGA clauses.¹³² The PGA language is clear and specific as to the implementation of the matching of gas costs with those customers for whom the gas supply is purchased, which is consistent with proper cost allocation.¹³³ Thus, any attempt to generalize the types of gas purchases that should be included in a utility's WACOG is meaningless.¹³⁴

In addition, Entex maintains that sound policy underlies the concept of matching or "streaming" gas costs. Specifically, Entex argues that the premise of Mr. Fowler's assumption is inconsistent with proper cost allocation, or assignment, methodology. Proper methodology requires cost assignment and allocation based on cost causation. Stated differently, costs are to be assigned to the class of service that generated the expense. Thus, when a particular cost is caused by one class of service as opposed to a different class, or several classes, that cost should be assigned directly to the class that caused the expense.¹³⁵

Despite its disagreement regarding the fundamental presumption, the City of Tyler agrees that specific and unequivocal language in the PGA could require the segregation, or assignment, of gas costs. The PGA clause may specifically provide for assignment, or matching of gas costs. Unless clearly stated otherwise, however, all gas supplies for an integrated system should be included in the calculations of the utility's WACOG.¹³⁶

¹³⁰ Entex Exhibit 2, Direct Testimony of Debra DePeña, p. 16, Ins. 10 - 17.

¹³¹ Entex Exhibit 3, Direct Testimony of Joe N. McClendon, p. 13, Ins. 16 - 22.

¹³² Entex Exhibit 3, Direct Testimony of Joe N. McClendon, p. 14, Ins. 4 - 14.

¹³³ Entex Exhibit 3, Direct Testimony of Joe N. McClendon, p. 15, Ins. 1 - 4.

¹³⁴ Entex Exhibit 3, Direct Testimony of Joe N. McClendon, p. 13, Ins. 1 - 14.

¹³⁵ Entex Exhibit 1, Direct Testimony of Charles J. Harder; Entex Exhibit No. 3, Direct Testimony of Joe N. McClendon, Direct p. 13, Ins. 3 - 14.

¹³⁶ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 6, Ins. 8 - 20.

b. Specific language

The City of Tyler does not believe that specific language in the Entex’s tariffs allowed matching of gas costs. On the other hand, Entex argued that specific language, clearly stated in the tariff, required matching. The residential and commercial tariff that delineated the PGA provided as follows: “The above net monthly rate per unit sold is predicated upon a price of **gas purchased for resale hereunder . . .**” Entex contends that the language “gas purchased for resale hereunder” was unequivocal language that required that Entex match its gas costs.

Entex asserted that, since at least 1982, the PGA clauses contained in the rate schedules required that Entex match the cost of gas supplies with the customers for whom the gas is purchased. The “streaming” or matching of gas costs, Entex maintains, was expressly discussed and approved in two contested cases by the Commission. Thus, the PGA clauses require that the cost of gas be matched with the customers for whom the gas is purchased.¹³⁷ The rate schedules established the approved regulatory mechanism for passing gas costs through to customers under the PGA clause for that particular class. According to Entex, the provision directly limits the pass through of gas costs. Only gas costs purchased for resale to the class of customer described in each tariff may be passed through to that class of customer. Thus, Entex must match, or assign, gas costs to the class of customer whose demand required the particular purchase of gas. Entex concludes that this is consistent with proper cost assignment or allocation.¹³⁸

Further, Entex maintains that the PGA clause contained in each of the tariffs requires that Entex include only gas purchased for resale for that class of customer and under that specific rate schedule. Entex maintains that the requirement is evidenced by the language contained in each rate schedule and that the PGA refers to only “Entex’s price of gas purchased for resale hereunder.” Entex concludes that unlike the gas cost recovery mechanisms of other utilities, Entex’s PGA explicitly directs the matching of gas purchases and sales by customer class.¹³⁹

The City of Tyler did not agree and its witnesses testified that the language did not justify the assignment or segregation of gas costs.¹⁴⁰ Mr. Fowler testified that only one provision in the tariff allowed any kind of segregation of costs based upon logical geographical area — a provision that was not applicable here. Nothing in the TGM contract permits Entex to exclude gas purchased pursuant to that

¹³⁷ Entex Exhibit 3, Direct Testimony of Joe N. McClendon, p. 10, lns. 15 - 17.

¹³⁸ Entex Exhibit 3, Direct Testimony of Joe N. McClendon, p. 12, lns. 1 - 7.

¹³⁹ Entex Exhibit 2, Direct Testimony of Debra DePeña, p. 4, lns. 10 - 19.

¹⁴⁰ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 18, lns. 5 - 22.

contract based upon geographic area.¹⁴¹ Mr. Fowler contends that the language was mere surplusage and that the utility never notified the City of Tyler that it interpreted the language to require or allow Entex to stream the gas costs.

c. Notification of Interpretation of Tariff

The City of Tyler also points out that it was never notified that gas costs were being assigned. Although Entex's monthly PGA filings indicated that Entex acquired a different supplier, Entex never revealed in its monthly PGA filings that the TGM contract existed.¹⁴² Entex responds that it was not required to inform the regulatory authorities about the TGM contract. Entex also maintains that it informed the City of Tyler, and the Commission, that the effect of the PGA language was to ensure that the gas cost charged to customers was priced on the basis of the supply of gas purchased for that customer.¹⁴³ As evidence in support of this proposition Entex points to the historical treatment and explanations of the PGA clause and the interaction between Entex and the City of Tyler.

In 1982, the PGA included a notice and filing requirement. That requirement was eliminated in subsequent city ordinances. Mr. McClendon argues that the City of Tyler knew, or should have known, that it would receive no notice of changes in the amount of gas cost charged and collected through the PGAs.¹⁴⁴ Furthermore, Entex has matched its gas costs since at least 1982, and the practice of matching gas purchase and sales to the responsible customer class has not changed since the PGA language was approved in 1982.¹⁴⁵

In addition, Entex argues that the City of Tyler was aware that it assigned gas costs. Entex sent a letter to Gary C. Landers, dated June 23, 1989, in which Entex explained that the gas supplies for residential and commercial customers are "necessarily and substantially higher than gas supplies for an industrial customer"¹⁴⁶ In 1984, the City of Tyler adopted a PGA clause for Entex that was identical to that discussed in GUD No. 3666. In GUD No. 3706, decided the same year as GUD No. 3666, Entex stated that "[t]he text of Entex's purchased gas adjustment provision applicable to firm customers does not provide that all gas purchased should be averaged into the PGA. Rather, the text of each of Entex's firm

¹⁴¹ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 17, lns. 24 - 25 & p. 18, lns. 1 - 4.

¹⁴² Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 28, lns. 12 - 16.

¹⁴³ Entex Exhibit 2, Direct Testimony of Debra DePeña, 10, lns. 8 - 12.

¹⁴⁴ Entex Exhibit 3, Direct Testimony of Joe N. McClendon, p. 15, lns. 6 - 11.

¹⁴⁵ Entex Exhibit 2, Direct Testimony of Debra DePeña, p. 14, lns. 20 - 24.

¹⁴⁶ Direct Testimony of Bruce Coogler, Exhibit BC-4, 2.

rate schedule's limits the components to only ' . . . Entex's price of gas . . . purchased . . . for resale hereunder.'"¹⁴⁷

In that case, Entex went on to explain that “[i]nterruptible gas purchased for a specific interruptible customer is not gas purchased for sale under any of Entex’s firm rate schedules and, therefore, could not properly be included in the PGA applicable to such schedules.”¹⁴⁸ In documents filed with the Commission, Entex offered the following explanation:

We take the gas purchased for the large volume customers and compute the cost of gas for those customers for those rate schedules. You see, we pay one price for the gas for the domestic customers, and we pay a different price for gas for the large volume customers. We have a two-tier pricing system from our primary supplier. So we segregate the cost of gas that is resold under the specific schedules and flow that cost through to those customers.¹⁴⁹

Ms. DePeña testified that the Commission, in GUD No. 3706, concluded that Entex’s calculation of its WACOG was in the public interest and that the gas cost purchased for specific large volume customers should not be included in the PGA calculation for residential and commercial customers. In that same proceeding, Entex explained further that “gas supplies for residential end use are necessarily and substantially higher than gas supplies for an industrial customer who uses the same amount of gas each and every day during the year and is willing to have service interrupted a few days of the year.”

The City of Tyler agrees that the 1982 proceedings, at the municipal level and at the Commission, resulted in rates that allowed the segregation of gas costs.¹⁵⁰ That segregation, however, was for one customer — and the potentially discriminatory rates were openly evaluated. Mr. Fowler concludes that GUD No. 3706 confirms that Entex was aware of how to properly obtain regulatory approval of, what the City of Tyler considers, a potentially discriminatory cost shifting practice. First, Entex filed an informative application with the regulatory authority with original jurisdiction. Second, Entex fully explained its proposal and provided a justification. Third, Entex obtained explicit approval from the regulator who could have rejected, modified, or fully accepted the proposal. These steps, Mr. Fowler maintains, were not taken with

¹⁴⁷ Direct Testimony of Debra DePeña p. 10, Ins. 14 - 24. Entex’s Closing Statement and Reply Brief in G.U.D. No. 3706 at 8.

¹⁴⁸ Entex Exhibit 1, Direct Testimony of Charles J. Harder, p. 22, Ins. 13 - 15.

¹⁴⁹ Entex Exhibit 2, Direct Testimony of Debra DePeña, p. 15, Ins. 22 - 26 & p. 16, Ins. 1 - 8.

¹⁵⁰ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 12, Ins. 16 - 24, 13 - 14, & 15, Ins. 1 - 17.

the City of Tyler, in the current context.¹⁵¹ In 1992, when Entex commenced the practice of expanding its program of segregating gas costs, it did not return to the regulatory authorities.¹⁵²

In addition, the City of Tyler argued that in the presentation made to the City of Tyler in 1992, Entex represented that the WACOG was derived by averaging all of the costs of Entex's pipeline suppliers and producers.¹⁵³ Thus, as argued by the City of Tyler, before 1982, there was only one WACOG cost pool that applied to all customers regardless of size. Between 1982 and 2002, the City of Tyler approved only one additional WACOG cost pool — for large volume interruptible customers, and Entex represented to the City of Tyler that it used a unified WACOG for its sales to Tyler IDS customers.

d. Examiners' Analysis and Recommendation

Although there is no statutory or regulatory definition of the term WACOG in Texas,¹⁵⁴ the Examiners agree that there is a fundamental presumption that a WACOG calculation includes all of the gas supplies acquired to serve the customers of the gas utility. Mr. Fowler correctly, and methodically, traced the history of PGA clauses in general, and in Texas, in particular, and established this presumption.

Nevertheless, Entex is correct that specific language in the PGA would defeat that presumption. Further, the Examiners agree that there is specific language in the tariffs on file for Entex customers that specifically authorizes cost assignment, or segregation, of gas costs. Rate Schedule No. R - 1446 - 2, for residential customers contains a specific PGA provision applicable to that tariff. Rate Schedule SC - 1446 - 2, for small commercial customers contains a specific PGA provision applicable to that tariff. Rate Schedule 590, for small industrial customers contains a PGA provision applicable to that tariff. Each provision refers to "gas to be purchased for resale hereunder."

Every tariff filed by Entex contains the same, or a similar, provision. For example, Rate Schedule 1969, applicable to medical facilities, provides, in pertinent part, as follows: "The Net Monthly Rate per unit sold provided for in this Rate Schedule is predicated upon a price of gas paid by Company on October 15, 1987, for gas purchased by Company for resale and delivery to Consumer under this Rate Schedule." This is very similar to the language contained in the residential and commercial tariffs. Some of the other tariffs applicable to the TGM Exhibit B Customers provide greater specificity. For example, Rate Schedule 1817, applicable to bakeries, provides in pertinent part, as follows: "The Net Monthly Rate per unit sold provided for in **this Rate Schedule** is predicated upon the price of gas paid by Company on May 15,

¹⁵¹ Tyler Exhibit 8, Rebuttal Testimony of G. William Fowler, p. 12, lns. 3 - 12.

¹⁵² Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 15, lns. 3 - 12.

¹⁵³ Tyler Exhibit 6 & Tr. Vol. III, p. 161.

¹⁵⁴ Tr. Vol. 1, p. 41, lns. 6 -14.

1989, to Company’s supplier or suppliers of natural gas for **large volume interruptible natural gas service** to the City of Tyler”¹⁵⁵ These tariffs unequivocally reveal that Entex segregated its gas costs.

Furthermore, while GUD Nos. 3666 and 3706, apply to a specific circumstance, the fact that Entex sought approval in subsequent tariff filings, using the same or similar language, would suggest that Entex intended to segregate, or assign its gas costs in those cases. The City of Tyler’s assertion that Entex correctly and openly applied for that treatment prior to 1992, is belied by the legislative history of GURA. Those cases occurred prior to 1985, and Entex was required to seek regulatory approval through a Statement of Intent - proceeding. Prior to 1985, GURA traced the language that was originally adopted in the Public Utilities Regulatory Act: “No utility may **make changes** in its rates except by filing a statement of intent with the regulatory authority having original jurisdiction at least 35 days prior to the effective date of the proposed change.”¹⁵⁶ Thus, any change in rates required the filing of a Statement of Intent. That requirement was subsequently narrowed. Effective June 11, 1985, that requirement was changed: “No utility **may increase** its rates except by filing a statement of intent with the regulatory authority having original jurisdiction at least 35 days prior to the effective date of the proposed increase.”¹⁵⁷

Furthermore, the Examiners agree that the language in the PGA requires matching or “streaming” in this case. Thus, calculating a pooled WACOG — WACOG_{Pooled} — for the entire Tyler IDS would have violated Entex’s filed tariffs. The filed rate doctrine prohibits regulated utilities from charging rates for their services other than those properly filed with the appropriate regulatory authority. As noted by the Austin Court of Appeals, the Texas Legislature codified the filed rate doctrine in the Texas Utilities Code.¹⁵⁸ Section 104.005(a) states: “A gas utility may not directly or indirectly charge . . . a person a greater or lesser compensation for a service provided . . . by the utility than the compensation prescribed by the applicable schedule of rates filed under Section 102.151.”¹⁵⁹

VIII. Tariff and Franchise Agreement: Did Entex inappropriately pass through \$5.2 million in capital costs?

¹⁵⁵ Entex Exhibit 3, Direct Testimony of Joe N. McClendon, Exhibit JNM-1, p. 38 (Emphasis added).

¹⁵⁶ Gas Utility Regulatory Act, 68th Leg., R.S., ch. 263, § 20, 1983, Tex. Gen. Laws 1161, 1207 (Emphasis added).

¹⁵⁷ Gas Utility Regulatory Act, 69th Leg., R.S., ch. 459, § 2, 1985 Tex. Gen. Laws 1617, 1618 (Emphasis added).

¹⁵⁸ *Montana - Dakota Utilities Co. v. Northwestern Public Service Co.*, 71 S.Ct. 692, 695 (1951); *Entex v. Railroad Comm’n of Texas*, 18 S.W.3rd 858, 862 (Tex. App. — Austin, 2000, pet. denied).

¹⁵⁹ TEX. UTIL. CODE ANN. § 104.055.

a. Arguments of the parties

Witnesses for the City of Tyler explained that a PGA clause is a mechanism for a utility to pass through only intended cost items. The PGA does not provide the utility a blank check to pass through any costs. The utility is still subject to all of its utility obligations, and the rates charged still need to be just and reasonable.¹⁶⁰ Mr. Fowler explained that PGA clauses at first were limited to what could be termed “traditional gas costs,” in other words, the cost of purchased gas from suppliers and not any other expenses. Items that would be included in traditional gas costs would be defined by the regulatory authority. For example, in 1969 when the Federal Power Commission (FPC) first allowed PGA clauses, purchased gas costs included gas from wellheads, field lines, plant outlets, transmission lines, and costs of underground storage. Gas costs not allowed without FPC approval were new pipeline production supplies, renegotiated gas contracts with affiliates, LNG, SNG, and gas from gasified coal. Other utility expenses, such as operating expenses, return on investment, or authorization of capital investments are not included in PGA clauses. Later, as gas marketing conditions changed with the advent of deregulation and the unbundling of gas streams, gas costs would include transportation, storage costs, as well as the commodity cost of gas.¹⁶¹

The City of Tyler argues that Entex inappropriately included up to \$5.2 million in capital costs as part of the PGA. The TXO contract included a \$5.2 million liquidated damages provision, apparently to compensate Delhi, the affiliate of Entex’s new gas suppliers, for capital costs that might be incurred by Delhi purportedly in connection with bringing a new lower priced gas supply to Entex’s Tyler IDS. The TXO contract provided liquidated damages to Delhi should Entex terminate the agreement early as the result of government regulatory interference.¹⁶² The liquidated damages amount would be reduced by \$1.30/MMBtu for each of the first 4,000,000 MMBtu’s purchased under the contract.

Mr. Pous, testifying on behalf of the City of Tyler, alleges that this amount was for non-gas related costs that Entex flowed through the PGA clause.¹⁶³ Mr. Niemiec testified that typically if a gas supplier is required to upgrade his pipeline and infrastructure to serve a new customer, then if when that contract is cancelled early the gas supplier would want to recoup the investments in the infrastructure that went unused due to the early cancellation. Based upon this experience he concludes that this amount, \$5.2 million, could

¹⁶⁰ Tyler Exhibit 1, Direct Testimony of G. Willim Fowler, p. 7, Ins. 19 - 26 & p. 8, Ins. 1 - 2.

¹⁶¹ Tyler Exhibit 1, Direct Testimony of G. William Fowler, , p. 5 Ins. 25 - 29, p. 6 Ins. 1 - 7.

¹⁶² TXO Contract, Page 17, paragraph 18(b) at City of Tyler Exhibit 1, Direct Testimony of G. William Fowler, Exhibit GFW-9.

¹⁶³ Tyler Exhibit 2, Direct Testimony of Jacob Pous, p. 5, Ins. 15 - 18.

only be for capital costs.¹⁶⁴ Mr. Pous points out that the customers that received the greatest benefits from access to cheaper gas supplier through the Delhi system were TGM Exhibit B Customers who did not bear any costs of Entex's General Service PGA clause under the TXO supply. Additionally, two of Entex's affiliates who also appear to be transportation customers, Unit Gas Transmission and Entex Gas Marketing, received similar benefits from the capital additions but bore none of the costs.¹⁶⁵

As evidence of the improper pass through, the City of Tyler offers the statement of Mr. Pous that the amount was not necessary for the purchase of gas but "probably was for capital costs." The City of Tyler points out that the \$5.2 million amount approximated the amount of all new capital facilities that Delhi's former officer, David Johnson, testified were added to serve the City of Tyler.¹⁶⁶ In addition, the City of Tyler states that Entex elected not to explain the purpose for the amount, other than to say that it was the "product of negotiation between the parties."¹⁶⁷ Finally, the City of Tyler alleges that part of the \$5.2 million in capital improvements included facilities transferred to Entex. The facilities deeded to Entex were inside the city limits of Tyler and were used to move gas to the north side of the Tyler IDS. Evidence was presented at the hearing that the facilities were valued at \$460,000. Entex would not have acquired the facilities but for the contract with Delhi.¹⁶⁸

As an initial matter, Entex claims that only gas costs have been passed through its PGA clause.¹⁶⁹ Mr. Johnson, who negotiated the TXO and TGM contracts on behalf of Delhi, TXO, and TGM, testified that there was no separate charge for facilities, gas storage, compression, or any other related cost. He testified that Entex was billed only for the cost of gas.¹⁷⁰ He testified that the facilities were deeded to Entex because neither TXO nor TGM wanted to become subject to the City of Tyler's regulatory authority.¹⁷¹ Furthermore, he testified that the amount of the liquidated damages provision was established independently

¹⁶⁴ Tyler Exhibit 3, Direct Testimony of Donald Niemiec, p. 13, Ins. 16 - 22.

¹⁶⁵ Tyler Exhibit 2, Direct Testimony of Jacob Pous, p. 6, Ins 12 - 25.

¹⁶⁶ City of Tyler' Written Closing Statement and Initial Brief, p. 24, citing testimony at Entex Exhibit No. 6, Direct Testimony of David Johnson, p. 8, Ins. 11 - 15. "The approximate value of the physical facilities supporting this sale excluding any leased storage is \$74.4 million This amount includes an estimated **\$4.95 million** in new assets constructed to service the TXO contract and approximately \$69.4 million in existing assets committed to service." (Emphasis added.)

¹⁶⁷ Tyler Exhibit 3, Direct Testimony of Jacob Pous, p. 6, Ins. 1 - 15.

¹⁶⁸ Tr. Vol. III, p. 35, Ins. 6 - 8.

¹⁶⁹ Entex Exhibit 2, Direct Testimony of Debra DePeña, p. 16, Ins. 19 - 24.

¹⁷⁰ Entex Exhibit 6, Direct Testimony of David Johnson, p. 12, Ins. 2 - 8.

¹⁷¹ Entex Exhibit 6, Direct Testimony of David Johnson,, p. 12, Ins. 22 - 23.

of the value of the pipeline improvements, undertaken to provide service to Entex, and was not tied to any specific financial outlay in constructing the new facilities.¹⁷² Mr. Coogler, who was involved in the negotiation of the contracts on behalf of Entex, echoed Mr. Johnson's testimony and stated that the \$5.2 million was the product of negotiation and not tied to any particular investment by TXO.¹⁷³ Ultimately, Entex did never paid TXO any amount of liquidated damages under the contract.

b. Examiners' Conclusions and Recommendations

The Examiners agree that the PGA should be used to pass through only the cost of gas. The Examiners agree, however, that the \$5.2 million was not passed by Entex to its customers as part of the gas costs. The Examiners do not find that there is sufficient evidence in the record to suggest that the costs of those improvements were a separate part of the cost of gas. Mr. Pous' tentative suggestion, and Mr. Niemiec's supposition, is insufficient evidence on which to find that capital expenditures were included in the PGA. Entex established, through the testimony of witnesses involved in the negotiations on both sides, that the \$5.2 million was a negotiated amount to provide TXO a guarantee by Entex of its intent to take volumes under the terms of the contract. It was not intended to pay Delhi for its capital expenditures.

IX. Prudence of Entex's Gas Purchase Practices

a. The Standard

The City of Tyler has raised several questions regarding the gas acquisition practices of Entex. First, the City of Tyler alleges that Entex did not consider various alternatives and ultimately did not choose a reasonable supply option — Delhi's affiliates, TXO and TGM. Second, the City of Tyler argues that Entex failed to consider several viable supply options and, as a corollary Entex should have considered acquiring unbundled gas supplies. Third, and, a central issue in this case, the City of Tyler argues that the amount paid to TXO, ETI + \$1.29 was simply excessive; the City of Tyler argues that the TGM gas supply option should have been negotiated for all customers. Fourth, and related to the discussion in Section VI above, the City of Tyler argues that the decision to offer a special rate, for essentially the same level of service, to the TGM Exhibit B Customers was unreasonable.

In its *Initial Post-Hearing Brief* and *Reply Brief*, Entex reasserts its position that neither the Commission, nor the City of Tyler, have the authority to conduct a prudence review. Entex reserves its right to assert in pending or future appeals or pleadings that there is no jurisdiction to conduct this type of review. Entex argues that if the Commission decides to exercise this jurisdiction, however, the standard that should be applied here should be the same standard that other commissions have implemented for

¹⁷² Entex Exhibit 6, Direct Testimony of David Johnson, p 14 - 16.

¹⁷³ Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 27, Ins. 3 - 23; Tr. Vol. III, 34 - 37.

prudence and for retroactive reconciliation of fuel costs. Specifically, Entex argues that the standard applied by the Public Utility Commission of Texas and upheld by Texas appellate courts should be applied here. Namely, prudence should be defined as follows:

The exercise of that judgment and the choosing of one of that select range of options which a reasonable utility manager would exercise or choose in the same or similar circumstances given the information or alternatives available at the point in time such judgment is exercised or option is chosen.¹⁷⁴

Both parties agree on this standard and the Examiners agree that this is the appropriate standard to apply.¹⁷⁵ The Examiners agree with Entex's analysis that prudence cannot be based on hindsight, that is, by using information that was not available to the utility and more than one prudent option may be available within range of options. Finally, the Examiners agree that the prudence standard does not require perfection. The Examiners agree with the City of Tyler that the filed rate doctrine does not preclude an examination of the prudence of Entex's gas management practices: "A rate cannot be deemed just and reasonable unless the utility was prudent in incurring the operating expense it seeks to pass through to consumers."¹⁷⁶

Despite basic agreement of the parties regarding the applicable standard, the parties disagree on the application of that standard to the evidence in the case. As explained by both parties, two methods of proof are available: (1) Contemporaneous documentation; and, (2) after-the-fact analysis. The City of Tyler notes that efforts to demonstrate prudent decision-making by retrospective analyses has been considered by the courts as defensive and more suspect.¹⁷⁷ The City of Tyler argues that there is little or no contemporaneous evidence and a heavier burden applies. Entex counters that ample contemporaneous evidence and after-the-fact evidence exists and both burdens have been met. In each instance, the nature of the evidence must be evaluated.

b. The Reasonableness of TXO, TGM, and alternatives considered.

The City of Tyler argues that in 1992 there were several supply options not considered by Entex.

¹⁷⁴ *Inquiry of the Public Utility Commission of Texas into the Prudence and Efficiency of the Planning and Management of the Construction of the South Texas Nuclear Project*, Docket No. 6668, see also 16 P.U.C. Bull. 183, 483 (June 20, 1990); *Application of Gulf States Utilities Company to Reconcile its Fuel Costs, for Permission to Delay Requesting a Surcharge, or in the Alternative, for a Surcharge to Recover Under-Recovered Fuel Expense*, Docket No. 15102, Order on Rehearing at 2 (June 24, 1997); *Gulf States Utilities v. Public Utility Comm'n of Texas*, 841 S.W.2d 459, 475 (Tex. App. — Austin 1992, writ denied).

¹⁷⁵ *CenterPoint Energy Entex Initial Brief on Prudence Standard*, p. 2; *City of Tyler's Written Closing Statement and Initial Brief*, p. 7.

¹⁷⁶ See, *Gulf States Utilities v. Public Utility Comm'n of Texas*, 841 S.W.2d 459, 464 - 465 (Tex. App. — Austin 1992, writ denied) ("*Gulf States*") (Issues regarding prudence of purchaser's decision to obtain power and price paid is not precluded by the filed rate doctrine.).

¹⁷⁷ *Gulf States*, at 476 (Tex. App. — Austin 1992, writ denied).

Entex argues that it considered several options, based upon its review of those options, and its experience prior to 1992, Delhi, and its affiliate, TXO, was a prudent choice for the Tyler IDS.

i. Arguments of the parties

During the hearing, Entex described at length its experience with Lone Star, United Gas Pipeline, and local production.¹⁷⁸ Problems experienced with distillates, moisture, hydrates and significant variances in BTU values were identified by Entex. In addition, Entex established that Lone Star had curtailed service to Entex in 1989.¹⁷⁹ Entex also concluded that, given the market conditions and growth within the Tyler IDS, a north and south interconnect would not only enhance reliability, it was required.¹⁸⁰ Entex was aware of the deliverability offered by the two available supply options. Lone Star, for example was connected only on the south side of the City of Tyler and United Gas Pipeline did not offer multiple points of entry into the Tyler IDS.¹⁸¹ Finally, Entex pointed out that in 1992, United Gas Pipeline appeared to be on the edge of bankruptcy.

Entex argues that the most reasonable gas supply option in 1992, was the TXO offer for delivery of gas through the Delhi system. Delhi operated an extensive network of gathering pipelines in the area and meet the requirements necessary to provide service to the Tyler IDS. TXO, an affiliate of Delhi, served as the marketing arm of Delhi. TXO guaranteed a firm gas supply sufficient to meet the peak demand of the residential and commercial customer classes. By reconfiguring Delhi's gathering system, TXO, together with Delhi could guarantee the quantity of gas sufficient to ensure the integrity of Entex's distribution system through multiple interconnections north and south of the Tyler IDS. TXO's financial size and willingness to dedicate facilities to meet the peak demand of the residential and commercial customer classes ensured a reliable source of gas supply during all weather conditions. Finally, Entex argues that several of the options suggested by the City of Tyler were either not available in 1992, or did not meet the quantity, quality and reliability requirements of the Tyler IDS.

The City of Tyler argues that in the 1990's there was a wide range of supply options and points out that the Tyler IDS was connected to two major pipeline systems, Lone Star and United Gas Pipeline. Entex failed to consider that the PG&E/Valero pipeline was also close enough to be a viable transportation option.¹⁸² In addition, Entex failed to consider numerous alternative supply arrangements for unbundled service and potential suppliers of substance: El Paso Pipeline, Louisiana Land and Exploration, Union

¹⁷⁸ See, Entex Exhibit 4, Direct Testimony of George F. Carl and Entex Exhibit 5, Direct Testimony of Bruce Coogler.

¹⁷⁹ Entex Exhibit 8, Direct Testimony of William Rodney Pennington, p. 30.

¹⁸⁰ Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 16, Ins. 1 - 10. Entex Exhibit 12, Rebuttal Testimony of William Rodney Pennington, p. 21, Ins. 4 -7.

¹⁸¹ Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 5.

¹⁸² Tyler Exhibit 2, Direct Testimony of Donald W. Niemiec, p. 5, Ins. 6 - 24.

Pacific Fuels, Shell, Tennessee Gas Pipeline, Texaco, Texas Gas Transmission, Conoco, Mobil, Coastal, and Williams. Instead, the City of Tyler alleges that Entex focused on a single option — Delhi Gas Pipeline Company.¹⁸³ Mr. Niemiec, former President of Union Pacific Fuels, Inc. (UPFI) provided testimony regarding UPFI. He stated that UPFI would had the capacity to meet the requirements of the Tyler IDS and would have been interested in supplying natural gas to the Tyler IDS.¹⁸⁴

ii. Examiners' Conclusion and Recommendation.

Entex's decision to select TXO and TGM as the primary supplier was prudent. There is, in fact, contemporaneous documentation that supports Entex's contentions regarding reliability problems of existing supply sources. TXO and TGM provided gas supplies that meet the reliability and quality requirements of the Tyler IDS. In addition, Entex provided extensive after-the-fact analyses which supports its decision to seek service from Delhi in 1992.

Although Entex challenges UPFI's ability to meet the natural gas requirements of the Tyler IDS, it appears that through its affiliate, Union Pacific Resources, UPFI might have been able to meet the quantity requirement. Mr. Pennington, however, testifying on behalf of Entex, established that in 1992, no pipeline offered transportation of no-notice, swing gas.¹⁸⁵ Thus, UPFI, nor any of the other marketer, could overcome this limitation. FERC Order No. 636, which would make that type of service available, was not fully implemented in 1992. Thus, UPFI and the other marketers were not available in 1992. Entex established that the option to connect the Tyler IDS to the Valero pipeline was not prudent because additional construction of that pipeline would have resulted in only one interconnect and, relatedly, substantial construction would have been required through the City of Tyler to reach the north side of the Tyler IDS.¹⁸⁶ Additional alternatives available from Carthage also required substantial construction of over fifty miles just to achieve one interconnection.¹⁸⁷

Finally, Mr. Niemiec explained that if UPFI had entered into a gas supply arrangement with Entex, it would have purchased gas from, or transported gas on, United Pipeline, Lone Star, Delhi, or Valero. Except for Valero, Entex considered the same entities. United Pipeline and Lone Star were rejected due

¹⁸³ City of Tyler's Written Closing Statement and Initial Brief, p. 3.

¹⁸⁴ Tyler Exhibit 2, Direct Testimony of Donald W. Niemiec, p. 6, lns. 19 - 27 & p. 7 lns. 1 - 8.

¹⁸⁵ Entex Exhibit 8, Direct Testimony of William Rodney Pennington, p. 7 - 11.

¹⁸⁶ Tr. Vol. IV, pp. 205 - 206.

¹⁸⁷ Entex Exhibit 8, Direct Testimony of William Rodney Pennignton, p. 33 & Exhibit WRP - 15.

to quality and reliability concerns.¹⁸⁸ Despite all of the available options identified, Mr. Niemiec's analysis focused on four entities — three of which Entex considered in 1992.

¹⁸⁸ Tr. Vol. I, p. 114, lns 24 - 25 & p. 115, lns. 1 - 4; Tr. Vol. IV, p. 120, lns. 14 - 25.

c. The Price Paid under TXO Contract was Reasonable

i. Arguments of the parties

The City of Tyler argues that the price under the TXO contract was unreasonably high. As an initial matter, Donald W. Niemiec argues that gas supplies in East Texas were abundant in the 1990s. In 1991, the price averaged \$1.43 per MMBtu for the entire year and, during the contract negotiation period, the price fell to \$1.01 per MMBtu.¹⁸⁹ In addition, Mr. Niemiec points out that an extensive pipeline network existed in east Texas that was integrated into the overall United States pipeline grid.¹⁹⁰

The City of Tyler argues that the TGM price would have been a reasonable pricing option for the entire Tyler IDS. Mr. Niemiec states that the TGM contract price was lower than UPFI would have been comfortable with, but, he argues that this particular pricing arrangement was freely agreed to by two unaffiliated parties — Entex and TGM. Additionally, the price was high enough for TGM to continually deliver quality, uninterrupted gas service throughout the entire Review Period. He states that there were critical supply periods during that time that would have resulted in interrupted deliveries, yet that never happened. Thus, he concludes that the TGM contract price is a reasonable market based price for firm gas supply. Further, the fact that Entex was able to obtain firm gas at that low price for hospital-like load requirements creates questions as to why Entex simultaneously agreed to pay a significantly higher price under the TXO contract.¹⁹¹ Mr. Niemiec testified that while a premium was paid for the variability of the load requirement of Tyler human needs customers, which was warranted, the amount of that premium in the TXO contract was excessive.¹⁹²

The purchases from TXO were priced at a premium of \$1.29 per MMBtu added to a base. That base was the East Texas Index (ETI). Mr. Niemiec agrees that the ETI index was a reasonable price component. He testified, however, that the \$1.29 per MMBtu premium was excessive.¹⁹³ That premium was approximately 100% of the full East Texas Index.¹⁹⁴ Mr. Niemiec argues that a premium of \$0.25 per MMBtu would have been reasonable because, he believes, that UPFI would have provided the same type

¹⁸⁹ Tyler Exhibit 2, Direct Testimony of Donald W. Niemiec, p. 3, lns. 11 - 22 & p. 4, lns. 1 - 18.

¹⁹⁰ Tyler Exhibit 2, Direct Testimony of Donald W. Niemiec, p. 4, lns. 19 - 23.

¹⁹¹ Tyler Exhibit 2, Direct Testimony of Donald W. Niemiec, p. 9, lns. 1 - 14.

¹⁹² Tyler Exhibit 2, Direct Testimony of Donald W. Niemiec, p. 9, lns. 21 - 25.

¹⁹³ Tyler Exhibit 2, Direct Testimony of Donald W. Niemiec, p. 11, lns. 1 - 2.

¹⁹⁴ Tyler Exhibit 2, Direct Testimony of Donald W. Niemiec, p. 11, lns. 2 - 3.

of service at that price.¹⁹⁵

The City of Tyler compares the TXO price to the price charged under the TGM contract. The TGM contract gas was priced at the Houston Ship Channel (HSC) index with no premium. Mr. Niemiec points out that the parties to that contract considered that price equivalent to the ETI plus \$0.09 per MMBtu. In 1998, the TXO contract price was renegotiated and shifted over to an HSC based pricing formula. The agreed price was the HSC index plus a premium of \$0.41. Since the pricing mechanism of the TGM contract did not change, Mr. Niemiec performed a calculation to convert that pricing mechanism to an ETI based price. This facilitates comparison of the two contracts after 1998. The 1998 TXO price change of HSC plus \$0.41 is, in the opinion of Mr. Niemiec, equivalent to ETI plus a \$0.50 premium.¹⁹⁶

Table 2
Mr. Niemiec's Comparison of Pricing Terms in TXO and TGM

	TXO Contract	TGM Contract
1992	ETI plus \$1.29 per MMBtu	ETI plus \$0.09 per MMBtu
1998	ETI plus \$0.50 per MMBtu	ETI plus \$0.09 per MMBtu

Finally, the City of Tyler notes that if the supply cost and other terms and conditions are reasonable, a long-term, bundled services contract for system supply is reasonable. Mr. Niemiec believes, however, that the premium of the TXO contract was excessive and, as a result, the long-term supply contract was unreasonable.¹⁹⁷

Entex maintains that the price under the TXO contract was reasonable. As discussed throughout Entex's testimony, Entex argued that it had limited supply options. TXO was the least expensive and most reliable option.¹⁹⁸ Entex criticizes, Mr. Niemiec, for his failure to consider the price cap in the TXO contract. The TXO cap limited the price Entex ultimately paid for gas to 95% of Entex's WACOG in the East Texas region. The contract required TXO to credit against the following year's gas prices amounts paid in excess of the price cap. Thus, the price cap determines the ultimate price, not the calculated amount based on the ETI used by Mr. Niemiec. The 95% cap meant that Tyler's residential customers paid at

¹⁹⁵ Tyler Exhibit 2, Direct Testimony of Donald W. Niemiec, p. 11, lns. 8 - 16.

¹⁹⁶ Tyler Exhibit 2, Direct Testimony of Donald W. Niemiec, p. 11, lns. 17 - 27 & p. 12, lns. 1 - 5.

¹⁹⁷ Tyler Exhibit 2, Direct Testimony of Donald W. Niemiec, p. 13, lns. 1 - 10.

¹⁹⁸ Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 15, lns. 5 - 7.

least 5% less than Entex's customers in the East Texas region, which includes Jacksonville, Henderson, Marshall, Nacogdoches, Lufkin, and others. The cap allowed the Tyler IDS to benefit from every reduction in cost anywhere in the East Texas region.¹⁹⁹ Entex presented testimony that although the contract price was \$1.29, the price cap resulted in a price of \$1.02 to 1.11.²⁰⁰ Finally, Mr. Coogler testified that the price paid under the TXO contract in 1997 represented the best option for firm gas supply available to Entex to meet the specific requirement of Tyler's residential and commercial load.²⁰¹

Additionally, under the TXO contract, TXO assumed the obligation to provide service to two points of delivery into the Tyler IDS: The North City Gate and the South City Gate. This obligation required that TXO significantly reconfigure its system and dedicate substantial facilities to meet its supply obligations to the Tyler IDS. In addition, TXO provided an alternate delivery point as a backup to the direct delivery point into the Tyler IDS. These points of delivery in the Tyler IDS enhanced the reliability of the gas supply.²⁰² Entex points out that to achieve the same level of service by installing additional pipe from Carthage and Valero would have resulted in substantially higher gas costs. Carthage was fifty-five miles away and Valero required five miles of new pipe to reach the southern interconnect, and substantial construction within the City of Tyler to reach the northern interconnect.²⁰³

ii. Examiners' Conclusion and Recommendations

The Examiners conclude that Entex negotiated a prudent price for natural gas supplies in 1992 and 1997. As discussed above, Entex experienced reliability problems with existing suppliers and it is important to note, in addition, that the City of Tyler had requested that Entex discontinue service with the existing supplier.²⁰⁴ The Examiners note that Mr. Niemiec provided little support for \$0.25 + ETI as a price available to Entex.²⁰⁵ Further, Mr. Niemiec's testimony regarding the abundance of supply is contradicted

¹⁹⁹ Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 15, lns. 9 - 20.

²⁰⁰ Tr. Vol. III, p. 37, lns. 1 - 3 (Mr. Coogler estimated that price cap had the effect of lowering the margin to \$1.02 - \$1.04 per MMBtu.); Entex Exhibit 8, Direct Testimony of William Rodney Pennington, p. 6 lns. 8 - 9 (Price cap had the effect of lowering the margin to \$1.11 per MMBtu).

²⁰¹ Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 24, lns. 9 - 14.

²⁰² Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 16, lns. 1 - 10.

²⁰³ Entex Exhibit 8, Direct Testimony of William Rodney Pennington, p. 45 (Carthage option); Entex Exhibit 12, Rebuttal Testimony of William Rodney Pennington, p. 9 - 15 (Valero option)

²⁰⁴ Entex Ex. 5, Direct Testimony of Bruce Coogler, p. 7, lns. 7 - 9.

²⁰⁵ Tyler Exhibit 2, Direct Testimony of Donald W. Niemiec (No supporting documents provided); Tr. Vol. I, pp. 109 - 111; Tr. Vol. IV, p. 102.

by his statement that there were critical supply periods during the Review Period.²⁰⁶ Nevertheless, the burden in this phase is not on the City of Tyler to establish the reasonableness of \$0.25 + ETI, rather the burden is on the utility to establish the reasonableness of the price it paid.

The Examiners are of the opinion that Entex has met this burden. By its definition the price cap resulted in a price that was lower than the prevailing market price in the region. Entex established that the effective price was lower than \$1.29 + ETI, and closer to \$1.11 + ETI. The Examiners agree that the supply options noted by the City of Tyler's witness required considerable construction costs. The end result, as conclusively established by Entex during the hearing, was that rates for gas supplies would have been higher than \$1.29 + ETI. Entex established that there were no supply options for the Tyler IDS that would have met the quality and reliability supplies of the Tyler IDS at the price proposed by the City of Tyler. Further, as already noted, the supply option emphasized by Mr. Niemiec, UPFI, would have acquired its supplies from many of the same entities that Entex considered — including Delhi.²⁰⁷ In the end, Mr. Niemiec implies that UPFI, as a middleman in the process, would have been able to negotiate a lower rate from the same, or similar, supplier. Once its fees and expenses were added into the mix, the rate charged to Entex would have been lower than what Entex was able to negotiate. The Examiners conclude that UPFI could not have provided the gas supply requirements of the Tyler IDS at the \$0.25 + ETI rate. Further, Entex established that supplies for the entire Tyler IDS could not have been acquired at the TGM price and the City of Tyler concedes that the TGM price was lower than it would have been comfortable with to supply the entire Tyler IDS. Significantly, the Examiners note that the City Attorney acknowledged that Entex succeeded in reducing the price of gas in 1992.²⁰⁸

d. Price Redetermination.

i. Arguments of the Parties

Entex had the option under the TXO contract to seek a redetermination of the contract price in October of 1997. Entex did not seek a redetermination of the TXO contract price until November of 1998.²⁰⁹ Except for a slight increase in the price of natural gas supplies, the City of Tyler argues that the conditions of the East Texas Gas market had not changed much from 1992.²¹⁰ He argues that if Entex had requested a price renegotiation on November 1, 1997, instead of waiting a year, a lesser premium could

²⁰⁶ Tyler Exhibit 9, Direct Testimony of Donald W. Niemiec, p. 9, lns. 6 - 8; Tr. Vol. I, pp. 97 - 100.

²⁰⁷ Tr. Vol. I, p. 114 - 115.

²⁰⁸ Tr. Vol. III, p. 195, lns. 23 - 24 & p. 196, lns. 9 - 11.

²⁰⁹ Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 22, lns. 17 - 23.

²¹⁰ Tyler Exhibit 2, Direct Testimony of Donald W. Niemiec, p. 14, lns. 1 - 11.

have been obtained a year earlier.²¹¹ The City of Tyler does not believe that the renegotiated price was reasonable and maintains that the renegotiated TXO price was \$0.25 per MMBtu too high compared to readily available market priced firm gas supplies.

Entex offered several reasons to explain why it delayed a price redetermination. First, Entex sought to preserve the benefit of the credit it had amassed under the price cap. The TXO contract guaranteed that the price paid under the contract would not exceed 95% of Entex's East Texas WACOG. The 95% limitation acted as a cap on the price paid. If at the end of the contract year Entex determined that its customers had paid more than this cap, then TXO must issue credits equal to the overage in the next year. In essence, gas prices the following contract year were reduced by the amount the prices exceeded the 95% cap in the previous contract year. Because the benefit of the price cap under the TXO contract is realized the following year, redetermination of the contract price in 1997, could have resulted in Entex losing the benefit of the price cap for contract year 1998. Entex calculated this credit from contract year 1997, to be \$0.27 per MMBtu for the contract year 1998. Second, Entex in 1997, still faced the same limited and unsatisfactory option for supply of its residential and commercial customers and Entex argued that it had little leverage with which to negotiate a more favorable price. Third, in 1997, Koch Industries (Koch) was about to acquire Delhi (Koch). The acquisition closed on November 1, 1997. Entex believe it would not have been productive to renegotiate the TXO contract amidst the turmoil created by the pending acquisition. Fourth, Entex was aware that the likely successor in interest to the TXO contract would be Koch after the acquisition. Entex is the single largest customer of Koch for firm gas service. Therefore, Entex believed its bargaining position would be more favorable after Koch acquired Delhi.²¹² By the time the price was redetermined, conditions changed. Koch acquired Delhi, and Entex had a long history with Koch. Entex enjoyed a favorable bargaining position by virtue of its status as Koch's largest customer of firm gas service. Entex was able to redetermine the price under the TXO contract under favorable terms.²¹³

ii. Examiners' Conclusion and Recommendation

The Examiners agree that it was prudent for Entex to delay its price redetermination under the contract. The evidence establishes a reasonable basis for Entex's decision to wait. While renegotiation may have been a prudent option, the Examiners agree that it was equally prudent to wait one year based upon the circumstances explained by Entex. As noted above, the prudence standard does not require perfection.

²¹¹ Tyler Exhibit 2, Direct Testimony of Donald W. Niemiec, p. 14, Ins. 14 - 21.

²¹² Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 22 & 24, Ins. 1 - 7.

²¹³ Entex Exhibit 5, Direct Testimony of Bruce Coogler, p. 24, Ins. 16 - 24 & 25, Ins. 1 - 2.

X. Affiliate Issues

a. Arguments of the parties

Unit Gas Transmission is an affiliate of Entex. Unit was involved in two sales transactions during the Review Period. One customer was Entex. The other customer was La Gloria Oil & Gas Refinery, an industrial plant. Unit built a gathering system in the Tyler area in 1973 to acquire local production from three producers.²¹⁴ In 1973, Unit entered into a contract with Entex for the sale of gas obtained by Unit from local producing wells to Entex for resale under Entex's firm service tariffs.²¹⁵ The Unit/Entex contract has been on file with the Commission since at least 1976.²¹⁶ Unit sold the gathered gas to Entex at its WACOG plus 7¢ per Mcf.

Unit purchased gas for La Gloria from TGM, pursuant to a separate contract.²¹⁷ The City of Tyler alleges that this allowed Entex another opportunity to segregate the low cost TGM gas supplies from the system WACOG. As a separate issue, the City of Tyler alleges that the per unit cost of gas charged to La Gloria was lower than the per unit cost of gas sold to Entex, for resale to residential and commercial customers. This resulted in a violation of the affiliate transaction standard.

Ms. DePeña testified that Unit's price to Entex was not higher than the prices charged by Unit to its other affiliate of divisions or to a non-affiliated person. She argued that there are no identical or similar sales by Unit to its other affiliates or division or non-affiliated persons. The gas sales by Unit to LaGloria are to a large commercial and industrial customer. The sale by Unit to Entex is a sale for resale.²¹⁸ Additionally, La Gloria is a high-load factor industrial end-user with alternate fuel capability. That was not the case, for Entex.

b. Examiners' Conclusions and Recommendations

Section 104.055(b) requires that each item or class of items charged to a gas utility by an affiliate be found reasonable and necessary and not higher than the charges to a third party or other affiliate for the same item or class of items. That standard applies to the operation of the PGA, as well as other cost

²¹⁴ Tyler Exhibit 19, Supplemental Testimony of G. William Fowler, p. 2, lns. 5 - 16.

²¹⁵ Entex Exhibit 25, Supplemental Rebuttal Testimony of Debra DePeña, pp. 1 - 2., Entex Exhibit 26, Supplemental Rebuttal Testimony of Wayne D. Stinnett, Jr.

²¹⁶ Entex Exhibit 26, Supplemental Rebuttal Testimony of Wayne D. Stinnett, Jr., p. 4, lns. 1 - 4.

²¹⁷ Tyler Exhibit 19, Supplemental Testimony of G. William Fowler, p. 3, lns. 7 - 13. Tyler Exhibit 18, pp. 6- 10.

²¹⁸ Entex Exhibit 25, Supplemental Rebuttal Testimony of Debra DePeña.

components of a utility. The Examiners agree with Entex that the Unit sales to La Gloria are not similar to its sale to Entex. The industrial customer is a high-load factor end use customer, whereas the sale to Entex is a sale for resale. Thus, the issues raised by the City of Tyler, related to Mr. Bohall, are not relevant.²¹⁹

Unlike the other TGM Exhibit B Customers, the record in this case clearly establishes that La Gloria was an industrial customer with alternative, less expensive sources of supply.²²⁰ The Examiners do not believe that the service to La Gloria, pursuant to a contract with TGM was discriminatory because La Gloria cannot be construed to be within the same class as other residential and commercial customers; La Gloria cannot be considered within the same class as small commercial customers; and, finally, even within the narrower Class 6 classification, all Class 6 customers apparently were provided the opportunity to enter into a Complementary Contract.

Finally, there is no evidence in the record that the status of La Gloria as an interruptible customer could be changed. Pursuant to Curtailment Order GUD No. 489, La Gloria, as an interruptible industrial customer would be the lowest priority in a curtailment event. In other words, the totality of Entex's contractual relationship with La Gloria, as governed by the contracts between Entex and La Gloria, the tariffs, and the contract between Unit and the gas supplier, is interruptible.

XI. Additional Claims by the City of Tyler

The City of Tyler has also raised several claims in this case which Entex claims are ancillary issues. These center around Entex's communications with the City of Tyler. Much of the direct and rebuttal testimony of Mr. Fowler, and the rebuttal testimony filed by Gary Landers, the City of Tyler City Attorney, is primarily directed at the issue of communications between Entex and the City of Tyler. First, the City of Tyler alleges that Entex should have clearly notified the regulatory authority about the existence of the TGM contract. Second, the City of Tyler argues that Entex was required to make monthly PGA filings for the TGM Exhibit B Customers. Third, the City of Tyler suggests that the TGM Exhibit B Customers were not eligible for service pursuant to a tariff filed under section 104.003 of the Gas Utilities Regulatory Act.

a. Notification of the TGM Contract and practices of Entex

The City of Tyler points out that it was not informed about the TGM Contract until September 28,

²¹⁹ Tyler Exhibit 19, Supplemental Testimony of G. William Fowler, pp. 3 - 5,

²²⁰ Entex Exhibit 25, Supplemental Rebuttal Testimony of Debra DePeña, p. 5, Ins. 10 - 13.

2001.²²¹ Mr. Fowler argues that Entex had an obligation to inform the City of Tyler about that contract pursuant to the requirements of the franchise agreement in effect during the Review Period.²²² Specifically, section 15-161(B) requires that Entex “promptly file with the City Clerk . . . rules, regulations, practices, terms, conditions, or standards governing the conduct” of Entex’s business.²²³ Entex argues that no obligation existed. In fact, the 1968 Franchise Agreement had a specific provision that required the filing of gas contracts: “The franchise holder shall never enter into any contract for the purchase of gas to be used in furnishing gas service under this franchise (except in emergency cases and then not to exceed a sixty-day period) without first submitting the same to and getting approval of the city governing body”²²⁴ The City Attorney confirmed that the provision was omitted in subsequent franchise agreements.²²⁵

The Examiners agree that there was no obligation to file the TGM contract or notify the City of Tyler of its existence. Mr. Landers, however, was unequivocal in his assertion that when the City of Tyler officials requested the information they were met with resistance.²²⁶ This assertion is troubling, and combined with Entex’s assertions regarding the PGA filing requirement, raises concerns about the lack of communication. The Examiners agree that Entex is required, under this franchise, to report practices of Entex that govern the conduct of its business. Entex’s practice of offering the special package of Complementary Contract and Backup Contract to selected customers should have been disclosed. Furthermore, the tariffs on file were incomplete. No reference is made in the tariff governing the Complementary Contract, that those entities are eligible for Backup Contracts governed by Tariff 590. That fact should have been disclosed to the City of Tyler.

b. PGA filings for Complementary Contract Customers

The City of Tyler explained that Entex was not filing calculations of the PGA for the TGM Exhibit B Customers as required and argued that such filings are required by section 102.151 of the Texas Utilities Code.²²⁷ Ms. DePeña stated during the hearing that the utility is not required to file PGA calculations with

²²¹ Tyler Exhibit 1, Direct Testimony of G. William Fowler, p. 15, lns. 11 - 13.

²²² Tr. Vol. I, pp. 77 - 80.

²²³ Tyler Exhibit 1, Direct Testimony of G. William Fowler, Exhibit GWF - 7, p. 19.

²²⁴ Entex Exhibit 1, Direct Testimony of Charles J. Harder, Exhibit CJH-2, pp. 10 - 11.

²²⁵ Tr. Vol. III, 163, lns. 4 - 9.

²²⁶ Tr. Vol. III, p. 174, lns. 18 - 24.

²²⁷ Tyler Exhibit 8, Rebuttal Testimony of G. William Fowler, p. 26, lns. 17 - 26 & 29, lns. 9 - 18; Tr. Vol. I, p. 31, lns. 13 - 15 & p. 80, lns. 1 - 6.

the regulatory authority. Ms. Depeña affirmed that the utility complied with the statute by filing its tariff and no PGA filing was required. As the PGA is only a component of the rate and the statute does not require the filing of components, the components that make up the rates are not required. Ms. DePeña further states that the Commission does not mandate the filing of calculations, accounting records, contracts or other data supporting the utility's gas costs.

Ms. DePeña is incorrect regarding her analysis of this statute. The statute provides that the utility shall file as a part of the schedules each rule or regulation that relates to rate and service provided by the utility. Furthermore, the rules of the Commission provide the specifics of the filing requirements for tariffs to be filed with the Commission. The City of Tyler, through its regulatory authority, can require more specific information or the details of the components which make up the calculated rate. The Commission's rule requires that each utility file all rates within the Commission's appellate or original jurisdiction. When the rate is based on a formula, the tariff should identify and report all components of the formula and must be filed within 30 days of the effective date of the change. The rule requires filing of the rate being charged, how the rate was calculated, what conditions or rule governs the rate charged and, if formula based, the components of the formula. At the moment the PGA calculation changes, that change must be filed.

As explained by the City of Tyler, those PGA filings would likely have assisted the City of Tyler in evaluating the rate structure reflected in the tariffs filed by Entex. Mr. Landers testified that the City of Tyler was not aware of the price differential between the customers served pursuant to a Complementary Contract and other customers.²²⁸ Although the City of Tyler could have enforced this requirement during the Review Period, the utility has the obligation of complying with the requirements of the statute. The problem was further compounded by the fact that the PGA filings for the residential and commercial customers were erroneous.²²⁹

c. Qualification for Section 104.003

Section 104.003(b) provides that a utility may enter into a contract that provides for a negotiated rate under certain circumstances. The statute provides that these negotiated rates are available for a pipeline-to-pipeline transaction or to a transportation, industrial or similar large volume contract customer.²³⁰ The rates are available if neither the gas utility nor the customer had an unfair advantage during the negotiations, the rate is substantially the same as the rate between the gas utility and at least two of those customers under the same or similar conditions of service, or competition does or did exist with another utility, another supplier of natural gas, or a supplier of an alternative form of energy. The City of

²²⁸ Tyler Exhibit 7, Rebuttal Testimony of Gary C. Landers, p. 4, lns. 1 - 6.

²²⁹ Tr. Vol. IV, pp. 144 - 162.

²³⁰ TEX. UTIL. CODE ANN. § 104.003(b).

Tyler argues that many of the TGM Exhibit B Customers did not qualify for treatment under this statute because Entex had not established that alternative sources of fuel were available for those customers.

Entex's definition of "large volume customer" is not consistent. The volume requirements, as expressed in the tariffs for the TGM Exhibit B Customers, range from 14,000 Mcf per year to over 300,000 Mcf. Ms. DePeña testified that Entex is required to follow NARUC and then FERC.²³¹ FERC defines small commercial customers as those customers consuming volumes generally less than 200,000 Mcf per year.²³² It is not clear that those lower volume customers, who did not have a viable alternative, qualified for an interruptible contract under section 104.003. The lack of an alternative calls into question the status of all of those customers. Accordingly, the Examiners recommend that Entex's current tariffs be immediately reviewed by the City of Tyler and the Commission to determine whether or not they should be rejected. Refiling the tariffs is appropriate to clarify the status of certain customers as eligible to receive service under Tariff 590. Finally, the City of Tyler also raised issues of fraud and collusion but have not indicated the statutory basis for those claims, nor the jurisdiction of the Commission to consider those claims.

XII. Rate Case Expenses

a. The Statutory and Regulatory Standard

The City of Tyler has requested \$1,142,124²³³ in actual expenses, and \$460,000²³⁴ in estimated expenses. Entex has requested \$1,598,366 in rate case expenses. Thus, the total actual rate case expenses at issue are \$2,740,490. Expense testimony was presented on behalf of the City of Tyler by G. William Fowler and on behalf of Entex by Thomas B. Hudson, Jr.

Generally, in ratemaking proceedings involving municipalities, the municipality and the utility may recover rate case expenses. The recovery of rate case expenses is premised on two provisions of the Texas Utilities Code. Section 103, addresses municipal rate case expenses.

Sec. 103.022. RATE ASSISTANCE AND COST REIMBURSEMENT.

(a) The governing body of a municipality participating in or conducting a ratemaking proceeding may engage rate consultants, accountants, auditors, attorneys, and engineers to:

²³¹ Tr. Vol. 6, p. 90, lns. 1 - 5.

²³² 18 C.F.R. § 481 (2004).

²³³ Tyler Exhibit 24, Rate Case Expense Testimony of G. William Fowler, p. 9, lns. 18 - 20.

²³⁴ *Id.*

(1) conduct investigations, present evidence, and advise and represent the governing body; and

(2) assist the governing body with litigation or a gas utility ratemaking proceeding before a regulatory authority or court.

(b) The gas utility in the ratemaking proceeding shall reimburse the governing body of the municipality for the reasonable cost of the services of a person engaged under Subsection (a) to the extent the applicable regulatory authority determines reasonable.²³⁵

The utility is generally, entitled to recover rate case expenses pursuant to section 104.051:

Sec. 104.051. ESTABLISHING OVERALL REVENUES. In establishing a gas utility's rates, the regulatory authority shall establish the utility's overall revenues at an amount that will permit the utility a reasonable opportunity to earn a reasonable return on the utility's invested capital used and useful in providing service to the public in excess of its reasonable and necessary operating expenses.²³⁶

In addition, Entex maintains that, as this Commission has determined that this is a ratemaking proceeding, the Commission has the authority to award the utility's reasonable expenses to permit the "utility a reasonable opportunity to earn a reasonable return on the utility's invested capital used and useful in providing service to the public."

Entex and the City of Tyler agree that, to the extent the Commission has jurisdiction to determine the recovery of rate case expenses, section 7.5530 of the Commission's rules also controls:

(a) In any rate proceeding, any utility and/or municipality claiming reimbursement for its rate case expenses pursuant to Texas Utilities Code, § 103.022(b), shall have the burden to prove the reasonableness of such rate case expenses by a preponderance of the evidence. Each gas utility and/or municipality shall detail and itemize all rate case expenses and allocation and shall provide evidence showing the reasonableness of the cost of all professional services, including but not limited to:

- (1) the amount of work done;
- (2) the time and labor required to accomplish the work;
- (3) the nature, extent, and difficulty of the work done;
- (4) the originality of the work;
- (5) the charges by others for work of the same or similar nature; and

²³⁵ Tex. Util. Code Ann. § 103.022.

²³⁶ Tex. Util. Code Ann. § 104.051.

- (6) any other factors taken into account in setting the amount of the compensations

- (b) In determining the reasonableness of the rate case expenses, the Commission shall consider all relevant factors including but not limited to those set out previously, and shall also consider whether the request for a rate change was warranted, whether there was duplication of services or testimony, whether the work was relevant and reasonably necessary to the proceeding, and whether the complexity and expense of the work was commensurate with both the complexity of the issues in the proceeding and the amount of the increase sought as well as the amount of any increase granted.

The parties have raised two jurisdictional arguments related to rate case expenses.

b. Jurisdictional argument of the City of Tyler

i. Arguments of the Parties

The City of Tyler argues that the Commission does not have the authority to consider rate case expenses and that the city ordinances ceding jurisdiction were for a limited purpose. The scope of the Commission's ratemaking function in this case is to determine compliance issues regarding Entex's tariffs and what expenses should have been included in the purchased gas cost adjustment clause during the Review Period. Rate case expenses are not a component of the gas cost adjustment, so they cannot be included in any correction of the gas cost adjustment.²³⁷ Thus, the City of Tyler contends that the issue regarding the appropriate level of rate case expenses was not ceded to the Commission. Additionally, the City of Tyler argues that if Entex were to recover its rate case expenses through a surcharge, as requested, that would be a rate increase. Any rate increase, however, requires the filing of a Statement of Intent pursuant to section 104.102(a).²³⁸ In order for the utility to recover rate case expenses in this proceeding, the utility must file a statement of intent with the City of Tyler, which maintains original jurisdiction over rates charged by Entex.

²³⁷ *City of Tyler's Written Closing Statement and Initial Brief on Rate Case Expenses*, p. 9.

²³⁸ TEX. UTIL. CODE ANN. 104.102.

Entex argues that the municipal ordinance ceding ratemaking jurisdiction in this case did not reserve to the City of Tyler the exclusive jurisdiction to determine rate case expenses.²³⁹ Entex maintains that any argument that the City of Tyler somehow withheld from the Commission any authority over Entex's rate cases expenses is erroneous. Entex argues that the Commission has determined that this is a ratemaking proceeding and that the Commission has the authority, having made that determination, to order recovery of rate case expenses from customers.²⁴⁰ Once the determination was made that this was a ratemaking proceeding, the issue of whether it was initiated through the filing of a formal Statement of Intent is irrelevant.²⁴¹

ii. Examiners' Conclusions and Recommendations

The January 8, 2003, ordinance ceding jurisdiction provided that the City of Tyler would like the Commission to review Entex's charges for gas sales during the period from November 1, 1992 through October 31, 2002. The ordinance indicated that the Commission was to determine whether Entex properly and lawfully charged and collected for gas sales to residential and commercial customers in the City of Tyler, to consider any appropriate remedies, and to enter any appropriate order. The ordinance also provided that the City of Tyler elects that the Commission "exercise exclusive original jurisdiction over gas utility rates, operations, and services in the municipality." The City of Tyler limited that by providing that the limited surrender of jurisdiction was for the purpose of "whether Entex properly and lawfully charged for gas sales to for [sic] residential and commercial customers in the City of Tyler . . ." during the Review Period. On June 30, 2004, the City of Tyler clarified the January 8, 2003, ordinance.

In that resolution, the City of Tyler noted that the prior ordinance surrendered "its jurisdiction over rates and services to the Railroad Commission regarding the dispute in order to present the matter to the Commission . . ." The City of Tyler also explained in that resolution that "had the City retained its original jurisdiction over the matters at issue in Gas Utilities Docket No. 9364, it would have ordered cost reimbursement under TUC Section 103.022 . . ." The resolution also explained that staff of the Commission was of the opinion that the City of Tyler had not made it clear that the prior ordinance intended

²³⁹ The City of Tyler issued an ordinance ceding jurisdiction on January 8, 2003 and a resolution clarifying that ordinance on June 30, 2004. The ordinance, Ordinance No. 0-2003-3, and resolution, Resolution No. R-04-18, are attached as **Exhibit 2** to this Proposal for Decision.

²⁴⁰ Entex points out that its position in this context does not waive its initial position that this docket is not a "ratemaking proceeding" eligible for rate case expense reimbursement under the Texas Utilities Code. *Initial Post-Hearing Brief on Rate Case Expenses of CenterPoint Energy Entex*, p. 1, fn 1, and *Reply Brief on Rate Case Expenses of CenterPoint Energy Entex*, p. 2, fn 2.

²⁴¹ Entex adds that the City of Tyler's position in this matter is perplexing given that the City of Tyler has persistently maintained that a formal Statement of Intent need not be filed for a proceeding to qualify as a rate case. *See, Reply Brief of Rate Case Expenses of CenterPoint Energy Entex*, p. 5.

to cede the ratemaking jurisdiction of the City of Tyler. As stated in Part 1 of that resolution, the purpose of the resolution was to clarify that the City of Tyler intended its ceding of jurisdiction to be a “ceding of ratemaking jurisdiction, and it intended the relief sought in that docket to be ratemaking in that **it would affect and change the compensation received by Entex for sales and service** on Entex’s Tyler Integrated Distribution System.”

The Examiners conclude from these statements, the arguments made by the City of Tyler in this proceeding, and based upon the prior interim order of the Commission on this issue, that this is a ratemaking proceeding. As it is a ratemaking proceeding, the Commission has jurisdiction to consider the rate case expenses of the City of Tyler pursuant to section 103.022 and 104.051. The City of Tyler argument that rate case expense recovery cannot be awarded a utility without a Statement of Intent is contrary to the ruling in Tex. R.R. Comm’n, *Request of the Texas General Land Office for Stay of Abandonment and for Establishment of Transportation Rate on Panther Pipeline, Ltd*, Docket No. 9291 (Gas Utils. Div. July 22, 2003) (Final Order).

c. Entex’s jurisdictional arguments.

i. Arguments of the Parties

Entex argues that the City of Tyler should be limited to those expenses that were directly related to this docket; expenses incurred in connection with other proceedings are not recoverable under section 103.022 of GURA. Entex identified four areas that it considers are outside the scope of these proceedings: (1) Costs dating to 1997 relating to investigation into gas purchasing options and franchise negotiations with Entex; (2) expenses of the municipal proceeding that the City of Tyler dismissed in January 2003; (3) costs of two original non-APA actions in Travis County District Court dealing with jurisdictional issues, as well as related appeals; and (4) expenses incurred in connection with the City of Tyler’s non-party amicus participation in a rate order appeal involving the Houston Environs.

ii. Examiners’ Conclusions and Recommendations

The Examiners agrees that expenses incurred in connection with the City of Tyler’s non-party amicus participation in a rate order appeal involving the Houston Environs cannot be construed as connected with proceedings in this case. Although, an issue on appeal was the jurisdiction of the Commission to undertake a prudence review, that case did not involve the City of Tyler. Further, while it may have been prudent for the City of Tyler to file an amicus in that case, it was not required in order to participate in this proceeding. The appeal was filed by Entex in that case to district court and the Commission, represented by the Office of the Attorney General, litigated that issue.

On the other hand, the Examiners find that the other proceedings and investigation were directly related to this case: (1) costs related to investigation into gas purchasing options and franchise negotiations;

(2) expenses of the municipal proceeding; and, (3) costs of district court litigation in support of the City of Tyler proceeding and jurisdiction. The reasonableness of those expenditures will be addressed below.

d. Specific adjustments

i. City of Tyler: Franchise negotiations

Entex argues that amounts expended by the City of Tyler for franchise negotiations should not be recovered in this case. Entex argues that franchise negotiations are not recoverable pursuant to section 103.022 and should not be recovered in this proceeding. The City of Tyler argues that those amounts should be recoverable as they represent part of the underlying investigation that developed into this case. The Examiners agree that in the absence of the prudence claims raised by the City of Tyler, a ratemaking proceeding regarding the prudence of Entex's gas management practice would not have been initiated. To the extent that those amounts can be identified they should not be recovered by the City of Tyler. At the hearing, Mr. Fowler, testifying on behalf of the City of Tyler, indicated that \$14,041.89 could be construed as part of franchise negotiations.²⁴² The Examiners recommend that it be disallowed.

²⁴² Tr. Vol. VI, p. 16, lns. 22 - 25 & p. 17, ln. 1.

ii. City of Tyler: Municipal proceedings.

Entex argues that amounts, identified as part of the municipal proceeding should not be recovered by either party. The City of Tyler's Ordinance No. 0-2003-3 abandoned any claim to those expenses; the City of Tyler disagrees. Entex maintains that if the City of Tyler is allowed to recover those amounts, that it is entitled to its expenses as well. Entex's expenses will be addressed below. The City of Tyler identified \$142,490.75 as amounts expended in municipal proceedings and argues that the municipal proceeding is not meaningfully separate from the proceeding at the Commission. This amount represents the underlying initial work that preceded this ratemaking proceeding. The Examiners agree with the City of Tyler, that work was part of this proceeding. The Examiners, however, do not believe that any of these amounts should be recovered as a surcharge from the ratepayers. The City of Tyler, was required to engage consultants to ascertain the several of the facts; it should not have been necessary to employ consultants to identify the issues discussed in section XI, above. First, Entex should have reported its practice of offering a special package of tariffs to one group of customers. Second, the tariffs filed in support of the Complementary Contracts should have referred to Tariff 590. Third, Entex was required to file its updated PGA for all customers. The Examiners recommend that Entex reimburse the City of Tyler for these expenses and that Entex not be allowed to recover those amounts as a surcharge.

iii. City of Tyler: Expenses related to district court proceedings.

Two district court proceedings emanated from proceeding related to this litigation. At the municipal level, Entex filed a petition for declaratory and injunctive relief. In that case Entex sought to enjoin the municipal proceeding.²⁴³ Entex also filed a lawsuit in district court to enjoin the proceedings at the Commission after the *Joint Petition* was filed.²⁴⁴ Entex argues that expenses related to district court litigation is not recoverable as part of this ratemaking proceeding. The City of Tyler argues that participation in both of these proceedings were directly related to this ratemaking proceeding. The Examiners agree that the issues raised by Entex in these proceedings address threshold issues of this case. Accordingly, the Examiners recommend that the City of Tyler be allowed to recover rate case expenses associated with those proceedings.

iv. City of Tyler Expenses: Communications with the press.

²⁴³ Reliant Energy Entex v. City of Tyler et al., No. GN203392 (201st Dist. Ct., Travis County), *Plaintiff's Original Petition for Declaratory and Injunctive Relief*.

²⁴⁴ CenterPoint Energy Entex v. City of Tyler et al., No. GN402169 (353rd Dist. Ct., Travis County), *Plaintiff's Original Petition for Declaratory and Injunctive Relief*.

The City of Tyler expenses include communications with the press. The parties acknowledge that those expenses have not been included in the past.²⁴⁵ The Examiners recommend that these expenses be excluded. Further, these expenses appear contrary to Commission regulations regarding recovery of expenses associated with advertising. Entex pointed out one entry associated related to newspaper communication made by Gaylord Hughey on September 25, 2002. The time associated with that entry is 4.5 hours. Mr. Hughey's rate associated with that entry is \$225 per hour. Accordingly, the Examiners recommend that \$1012.50, be disallowed.

v. *City of Tyler Expenses: Expenses for the City Attorney.*

The City of Tyler seeks recover for expenses associated with the City Attorney for the City of Tyler. As pointed out at the hearing, city employees sometimes work supporting outside lawyers, but the parties do not seek recovery of those expenses.²⁴⁶ Tom Hudson, testifying on behalf of Entex regarding rate case expenses, noted that recovery by the City of Tyler for rate case expenses in this case would be double recovery, since the salary for the City Attorney is already a part of the City of Tyler's budget.²⁴⁷ The Examiners agree, that fees associated for the City Attorney's participation in this case should be disallowed. Furthermore, section 103.022 appears to contemplate recover of expenses for individuals or entities "engaged" to conduct, or prepare, the ratemaking proceeding. The Examiners recommend that the entire amount associated with the City Attorney be disallowed as a rate case expense: \$14,445.71.

vi. *Entex: Expenses for General Counsel of Entex*

Entex seeks to recover the amounts for its General Counsel. Mr. Hudson, testifying on behalf of Entex acknowledged that including expenses for the General Counsel was, to some extent, double recovery.²⁴⁸ The Examiners recommend that expenses associate with Entex's General Counsel be disallowed: \$119,226.14.

vii. *Entex: Municipal Proceedings*

Entex identified the amount it expended during the municipal proceedings as \$349,253.79. For the reasons discussed in subsection (ii) above the Examiners recommend that this entire amount be disallowed. The Examiners, however, do not recommend that any of these amounts be recovered as a surcharge from the ratepayers of the Tyler IDS. The City of Tyler, was required to engage various

²⁴⁵ Tr. Vol. 6, p. 53, lns 4 -18.

²⁴⁶ Tr. Vol. 7, p. 8, lns. 21 - 22.

²⁴⁷ Tr. Vol. 7, p. 9, ln. 25 & p. lns. 1 - 10.

²⁴⁸ *Id.*

consultants to ascertain several of the facts disclosed in this case. Specifically, it should not have been necessary for the City of Tyler to employ consultants to identify the issues discussed in section XI, above. First, Entex should have reported its practice of offering a special package of tariffs to one group of customers and not another. Second, the tariffs filed in support of the Complementary Contracts should have referred to Tariff 590. Third, Entex was required to file its updated PGA for all customers, including TGM Exhibit B Customers.

viii. Expenses associated with GUD No. 9469.

GUD 9469 involved the City of Houston environs rates charged by Entex. Entex filed an appeal of the order issued by the Commission in that case. Entex appealed two aspects of the final order. First, Entex appealed issues related to franchise fees that Entex sought to have charged to the environs customers of the City of Houston. Second, Entex appealed a provision included in the ordering paragraph related to the Commission's authority to conduct a prudence review of Entex's gas management practices. Entex argues that those expenses should not be recovered in this proceeding. The Examiners agree. Entex identified its expenses for GUD 9469 as \$50,542.86. The City of Tyler has not specifically identified those amounts. Entex argues that all of the City of Tyler's expenses should be disallowed because the City of Tyler has failed to identify the appropriate amount. A disallowance of all of the City of Tyler's expenses would not be reasonable. Instead the Examiners recommend that a disallowance equal to the amount expended by Entex in appealing that case be disallowed. Thus, the total disallowed amount is \$101,085.72.

ix. Expenses associated with deposition of Rollie Bohall.

On December 2, 2004, the City of Tyler filed the testimony of Rollie Bohall as an adverse witness. This testimony was filed in disregard of the procedural schedule and shortly before the hearing was to commence. The prefiled testimony was a one hundred and fifty-six page deposition. As noted in the discussion regarding the procedural schedule, in section I(c) above, Entex filed objections to the last minute filing.²⁴⁹ Initially, the Hearings Examiner ruled that the testimony should be stricken.²⁵⁰ Nevertheless, the Hearings Examiner allowed the City of Tyler to refile the testimony and designate particular portions to be included in the record. The City of Tyler filed portions it believed were relevant. No prior motion to modify the procedural schedule had been filed by the City of Tyler. Further, the Examiners found that Entex had not hindered the scheduling of the deposition. Nevertheless, the Examiners ruled that the designated portions would be allowed as prefiled testimony in support of issues raised in Phase I and Phase

²⁴⁹ See, *Objection and Motion to Strike Adverse Testimony of Rollie Bohall and Supplemental Testimony of William Fowler and Donald Niemiec*, and *Objection of CenterPoint Energy Entex to Deposition Testimony of Rollie G. Bohall*. filed on December 6, 2004.

²⁵⁰ Tr. Vol. I, p. 10, lns. 22 - 25.

II.²⁵¹ Due to the late filing considerable time and expense was spent in addressing issues related that deposition. Entex indicated that it expended \$5,190.00, in addressing those issues. The Examiners recommend that this amount be deducted from the amount requested by the City of Tyler.

x. Examiners' Conclusions and Recommendations.

In conclusion, the Examiners recommend that the amounts requested for rate case expenses be adjusted based on the above recommendations. The City of Tyler should recover no more than \$1,070,933.87; Entex should recover no more than \$1,079,344.14. Thus, the Examiners recommend that the total amount of rate case expenses be \$2,150,278.01. The Examiners recommend that of that amount, Entex be allowed to recover \$2,007,787.26 through a surcharge. In addition, both parties seek additional costs to further litigate this case at the Commission and on further appeal. Entex estimated that \$232,000 would be expended to complete these proceedings at the administrative level and \$210,000 would be required to litigate this case on appeal. The City of Tyler estimated that \$160,000 was required for completion of this case at the administrative level and an additional \$150,000 was required for an appeal. Therefore the total additional rate case expense requested by the parties in this case is \$752,000.

The Examiners find that the estimated future rate case expenses are excessive. Accordingly, the Examiners recommend that the parties file a separate docket, either at the Commission or at the municipal level, after the conclusion of all future proceedings related to this case, if they intend to recover those expenses. The appropriate period of time to recover actual rate case expenses was not litigated by the parties. The Examiners recommend that the rate case expenses be recovered over a period of sixty (60) months.

Respectfully submitted,

Gene Montes
Hearings Examiner
Office of General Counsel

Mark Brock
Technical Examiner

²⁵¹ TEX. ADMIN. CODE § 1.121(b)(14).

RAILROAD COMMISSION OF TEXAS

**JOINT PETITION OF CENTERPOINT §
ENERGY ENTEX AND THE CITY OF §
TYLER FOR REVIEW OF CHARGES FOR §
GAS SALES**

**GAS UTILITIES DOCKET
NO. 9364**

PROPOSED ORDER

Notice of Open Meeting to consider this Order was duly posted with the Secretary of State within the time period provided by law pursuant to TEX. GOV'T CODE ANN. Chapter 551 *et seq.* (Vernon 1994 & Supp. 2004). The Railroad Commission of Texas adopts the following findings of fact and conclusions of law and orders as follows:

FINDINGS OF FACT

BACKGROUND AND HISTORY

1. Centerpoint Energy Entex (Entex) owns and operates a gas distribution system in and around the City of Tyler referred to as the Tyler Integrated Distribution System ("Tyler IDS").
2. The Tyler IDS is part of the Entex/Beaumont East Texas Division.
3. The Tyler IDS provides natural gas service to approximately 32,000 residential, commercial, and large volume customers in, and adjacent to, the City of Tyler and Bullard, Texas.
4. Approximately 26,000 customers reside within the City of Tyler, approximately 400 customers are in the City of Bullard, and approximately 5,600 customers are in the unincorporated areas near the City of Tyler.
5. In 1990, the City of Tyler and Entex entered into a franchise agreement that expired in 2000.
6. The City of Tyler began examining issues related to Entex's franchise agreement in 1997.
7. The focus of review of the franchise agreement was a period from November 1, 1992, through October 31, 2002. That period is referred to by the parties to this proceeding as the "Review Period."
8. In particular, the review focused on the activities of Entex with regard to the operation of its purchase gas adjustment clause (PGA).
9. The City of Tyler notified Entex that it would commence a hearing on September 25, 2002, to consider the propriety of Entex's gas purchase practices.

10. On September 17, 2003, Entex filed a petition at the Railroad Commission seeking a declaratory judgment. That case was docketed as GUD No. 9337.
11. Entex also filed a proceeding in district court seeking to enjoin the proposed action of the City of Tyler.
12. The parties entered into discussions to determine the appropriate venue for resolution of the issues related to the purchase gas adjustment clause.
13. The parties agreed to bring the case to the Commission as an original jurisdiction matter.
14. The City of Tyler ceded its ratemaking jurisdiction pursuant to Section 103.001 of the Texas Utilities Code on the limited issue of “whether Entex properly and lawfully charged and collected for gas sales to residential and commercial customers in the City of Tyler during such period, to consider any appropriate remedies, including but not limited to, refunds, with interest, and to enter such orders as may be appropriate.”
15. The *Joint Petition for Review of Charges for Gas Sales (Joint Petition)* was filed on January 22, 2003.
16. The district court proceeding and GUD No. 9337 were subsequently simultaneously dismissed.
17. Notice of Hearing was issued on November 18, 2004, and a hearing was held from December 7, 2004, through December 17, 2004. A supplemental hearing on rate case expenses was held on January 17, 2005.
18. On May 12, 1992, Entex entered into two gas supply contracts for the Tyler IDS.
19. One contract was executed with TXO Gas Marketing Corp. (TXO) and the other was executed with Texas GasMark, Inc. (TGM).
20. TXO and TGM were affiliates of Delhi Gas Pipeline Corporation (Delhi).
21. The TXO contract supplied gas to Entex for its residential and commercial customers, whereas the TGM contract supplied gas to Entex for a group of customers referred to in the TGM contract on Exhibit B (TGM Exhibit B Customers).
22. The TGM Exhibit B Customers were identified in 1992 as follows: Brookshire Grocery, Carrier Air Conditioning, Flowers Baking, Jewell Concrete Products, Medical Center Hospital, Mother Frances Hospital – Laundry, Mother Frances Hospital, RexHide, Vesuvius USA.

23. Throughout the Review Period several customers were added to the list of customers supplied gas by TGM. Those customers became part of the group of customers referred to collectively, as the TGM Exhibit B Customers.
24. Entex filed tariffs for all of its several classes of customers and individual contract customers.
25. The residential tariffs in effect during the review period were: Rate Schedule No. R - 1446 - 2, Rate Schedule R - 981 - 2, Rate Schedule R - 1758 - 2.
26. The small commercial tariffs in effect during the review period were: Rate Schedule No. S - 1446 - 2, Rate Schedule SC - 981 - 2, and Rate Schedule SC - 1758 - 2.
27. The TGM Exhibit B Customers were governed by various tariffs including: Rate Schedule 1549, 1696, 1817, 1834, 1977, 2007, 2014, 2027, 2058, 2077, 2131, 2141, 2184, 2223, 2225, 2288, 2250, 2254, 2326, 2305, 2332, 2340, 2367, 2402, and 2461.
28. The TGM Exhibit B Customers also were governed by Rate Schedule 590, to the extent that those customers decided to take service under that tariff.
29. The TGM Exhibit B Customers had two contracts with Entex.
30. One contract, referred to as the Complementary Contract, provided service through one of the various tariffs referred to in Finding of Fact No. 27, referred to above.
31. The other contract provided backup service and was governed by the rates in Rate Schedule 590 (Backup Contract).
32. The TGM Exhibit B Customers, in the event of service interruption pursuant to the Complementary Contract, and corresponding tariff, had the ability to take service pursuant to the Backup Contract.
33. Gas supplies for customers receiving service pursuant to Rate Schedule 590 were supplied by TXO as part of the contract that was entered into on May 12, 1992.
34. Rate Schedule 590 was also available to Entex's other commercial customers.
35. The TXO contract was intended to meet both the base load and the peak requirements of the residential and commercial customers for the Tyler IDS.
36. The TXO contract was a no-notice gas supply contract.
37. The TXO contract was backed by a guaranty agreement with Delhi, and provided an added measure of supply reliability.

38. The TGM contract was a base-load gas supply contract for service to the customers identified on Exhibit B.
39. The gas supplied under the TGM contract was more likely to be interrupted than the gas supplied pursuant to the TXO contract.

DISCRIMINATION

40. Customers who were supplied exclusively by the TGM contract had a greater measure of risk of interruption, than customers supplied gas from the TXO contract.
41. The TGM Exhibit B Customers received service under a Complementary Contract, and corresponding tariff, and also had a Backup Contract.
42. The combined Complementary Contract and Backup Contract resulted in the same level of risk associated with customers receiving service exclusively from the TXO contract.
43. Some of the TGM Exhibit B Customers were not interruptible customers.
44. Not all commercial customers were offered service under a Complementary Contract and a Backup Contract.
45. Not all Class 3 and Class 5 customers were offered service under a Complementary Contract and a Backup Contract.
46. The TGM Exhibit B Customers received the same level of service from Entex as the other commercial customers but paid a lower price for that service.
47. Some of the TGM Exhibit B Customers were identified by Entex as Class 3 and Class 5 customers.
48. Class 3 and Class 5 classification were defined by volume.
49. Entex did not offer a Complementary Contract and a Backup Contract to all Class 3 and Class 5 customers.
50. Entex did not offer a Complementary Contract and a Backup Contract to all Class 3 and Class 5 customers.

51. A customer who had a Backup Contract governed by Tariff 590 was less likely to be interrupted pursuant to Curtailment Order GUD No. 489.
52. Because the TGM Exhibit B Customers received essentially the same level of service as the other commercial customers, Class 3, and Class 5 customers, at a reduced rate, the rate structure was discriminatory.

PURCHASED GAS ADJUSTMENT CLAUSES

53. The cost of gas is the most significant expense for a gas utility, often responsible for up to 70%, or more of the full price to consumers.
54. Gas costs may be recovered through an escalator clause, referred to as the purchase gas adjustment clause.
55. All tariffs filed by Entex contained a provision allowing the pass through of gas costs through a purchase gas adjustment clause.
56. There is a fundamental presumption that a purchase gas adjustment clause does not allow the segregation of gas costs.
57. There is a fundamental presumption that a purchase gas adjustment clause requires that all gas costs of a utility be aggregated in calculating the weighted average cost of gas.
58. The fundamental presumption is not applicable where specific language in the tariff provides that a utility may assign gas costs to particular customers, or customer classes.
59. Unless otherwise provided, a utility collects only its approved gas costs through a purchase gas adjustment clause.
60. A utility may not collect the direct cost of facilities through the purchase gas adjustment clause.
61. Facility reimbursement or the cost of physical plant is recovered through the cost of service rates of the utility.
62. All of the tariffs on file for Entex specifically contemplate the assignment of gas costs to particular customers, or customer classes.
63. Specific language in the tariffs filed by Entex require that Entex assign the costs of gas acquired to serve specific customers, and specific customer classes.
64. Entex did not pass through capital improvement costs of its gas supplier through the operation of the purchase gas adjustment clause.
65. Entex did not acquire assets through the operation of the purchase gas adjustment clause.

PRUDENCE

66. The Commission has the regulatory authority to conduct a prudence review of the utility's gas management practices.
67. A rate cannot be deemed just and reasonable unless the utility was prudent in incurring the operating expense it seeks to pass through to customers.
68. The prudence standard, adopted by other agencies of the State of Texas, and approved by Courts in Texas, is appropriate in this case: The exercise of that judgment and the choosing of one of that select range of options which a reasonable manager would exercise or choose in the same or similar circumstances given the information or alternatives available at the point in time such judgment is exercised or option is chosen.
69. A utility has a regulatory responsibility to make prudent business decisions regarding its gas purchase supply practices.
70. A utility should seek the lowest cost of gas with the highest reliability for its customers.
71. The quality and reliability of natural supplied to the Tyler IDS were prudent concerns of Entex.
72. Prior to 1992, Entex obtained gas supplies from Lone Star, United Gas Pipeline, and local production.
73. Entex experienced quality and reliability problems from these sources of supply.
74. Local production was insufficient and not reliable to meet the demands of the Tyler IDS.
75. Entex experienced reliability problems with United Gas Pipeline, and its other gas suppliers, prior to 1992.
76. Among the problems experienced, Entex experienced quality problems with distillates, moisture, hydrates, and significant variances in BTU values.
77. Lone Star connected only to the south side of the City of Tyler and Entex had been curtailed by Lone Star in 1989.
78. Due to the market condition in the Tyler IDS two interconnections into the Tyler IDS were desirable to guarantee delivery of gas supplies.
79. Entex prudently endeavored to obtain gas supplies that would result in an interconnection in the north side of the City of Tyler and on the south side of the City of Tyler.

80. In 1992, no pipeline offered transportation of no-notice swing gas in the East Texas area.
81. Valero did not offer a suitable supply option for the Tyler IDS because it would result in only one connection on the south side of the City of Tyler, and substantial construction through the City of Tyler to reach the north side.
82. In 1992, TXO offered delivery on the Delhi system to the Tyler IDS that was reliable.
83. The quality of the natural gas offered by TXO and TGM was sufficient to meet the requirements of the Tyler IDS.
84. Delhi operated an extensive network of gathering pipelines in the Tyler area and was able to meet all of the requirements necessary to serve Entex's residential and commercial customers in the Tyler IDS.
85. Delhi reconfigured its system to allow multiple lines of entry to the Tyler IDS.
86. At the beginning of the Review Period, Entex considered four sources for the Tyler IDS gas supply: United, Lone Star, local production, and Delhi.
87. Options proposed by the City of Tyler included Union Pacific Fuels, Inc.
88. Union Pacific Fuels, Inc. would have purchased gas from many of the same sources considered by Entex, including Delhi.
89. Union Pacific Fuels, Inc. would have transported gas on pipelines operated by United, Lone Star, Delhi, and Valero.
90. Transportation of natural gas on United and Lone Star would not have been prudent because of the reliability problems experienced by Entex.
91. Transportation of natural gas on Valero to the south side of the City of Tyler would have resulted in higher gas costs than the costs Entex expended during the review period.
92. Delivery of natural gas on Valero would have required substantial construction through the City of Tyler to reach the north side of the Tyler IDS.
93. Natural gas supplies from Carthage would have required construction of fifty-five miles of pipeline.
94. The selection of Delhi's affiliates TXO and TGM was reasonable.
95. Delhi, through the contract with TXO, provided a Guaranty Agreement with Entex.
96. The Guaranty Agreement with Delhi assured the reliability of TXO's service.

97. The amounts of gas supplied to Entex pursuant to the TGM contract were insufficient to meet the requirements of the Tyler IDS.
98. Natural gas supplies that meet the quantity and reliability requirement of the Tyler IDS could not have been obtained at the TGM contract price.
99. Natural gas supplies that met the quantity, quality, and reliability requirements of the Tyler IDS could not have been obtained at 25¢ plus the East Texas Index per MMBtu.
100. The TXO contract guaranteed that the Tyler IDS would pay only 95% of the cost of gas paid by the surrounding east Texas weighted average cost of gas supplied to Entex.
101. As a result of the price cap, Entex paid approximately \$1.11 plus the East Texas Index per MMBtu.
102. A price of \$1.29 plus the East Texas Index per MMBtu was a reasonable price to pay during the Review Period to obtain natural gas supplies that meet the quantity and reliability of the Tyler IDS.
103. Pursuant to the terms of the contract between TXO and Entex, Entex had the opportunity to renegotiate the contract price in October of 1997.
104. Entex delayed renegotiating the contract until November of 1998.
105. Entex delayed renegotiating the contract because it would lose the benefit of the price cap.
106. In 1997, Delhi was in the process of being acquired by Koch Industries.
107. Entex was the single largest customer of Koch, and believed that its negotiating leverage would improve after TXO was acquired by Koch.
108. The decision by Entex to delay the price renegotiation until November of 1998 was reasonable.
109. The price paid under the renegotiated contract of 41¢ plus the Houston Ship Channel Index per MMBtu was reasonable.

AFFILIATE TRANSACTIONS

110. Unit Gas Transmission is an affiliate of Entex.
111. Unit Gas Transmission was involved in two sales transactions during the Review Period: One customer was Entex, the other customer was the La Gloria Oil & Gas Refinery.

112. Unit Gas Transmission purchased gas for La Gloria Oil & Gas Refinery from TGM, pursuant to a separate contract between Unit and TGM.
113. La Gloria, unlike some of the other TGM Exhibit B Customers, was an industrial customer and had viable alternatives to natural gas supplied by Entex.
114. La Gloria, as an interruptible industrial customer, was more likely to be interrupted than other Entex customers pursuant to Curtailment Order GUD No. 489.
115. The sale of natural gas from Unit Gas Transmission to La Gloria Oil & Gas Refinery is not identical, or similar to the sale of natural gas to Entex.
116. The sale of natural gas to La Gloria Oil & Gas Refinery is sale to an end use industrial customer, whereas the sale of natural gas to Entex, is a sale of natural gas for resale.

TARIFFS AND RATES

117. Tex. Util. Code § 102.151 requires gas utilities to file schedules showing all rates that are subject to the regulatory authority's original or appellate jurisdiction in effect for a service, product or commodity offered by the utility.
118. Pursuant to 16 TEX. ADMIN. CODE § 7.315(c)(7) if the rate the utility charges is based on a formula or requires a calculation to determine the unit rate to be charged, the utility shall identify in the tariff all components used in the calculation of the unit rate, including each component of the cost of gas.
119. Any change in the rates charged by the utility is required to be filed within thirty days of the effective date of the change.
120. All tariffs approved by the City of Tyler, and filed with the City of Tyler, included a purchased gas adjustment clause.
121. Entex is required to file tariffs to include schedules that identify the rate, the components of the rate, any formula and the rules or conditions affecting the rates with the regulatory authority.
122. A gas utility has a regulatory responsibility to disclose to the regulatory authority the terms and conditions of the rates being offered to the customer.
123. Entex failed to file its purchase gas adjustment calculation for the TGM Exhibit B Customers throughout the Review Period.
124. The PGA filings for the residential and commercial customers made by Entex during the Review Period were either incomplete or incorrect.

125. If Entex had filed its purchase gas adjustment calculation for all customers, as required by the statute, the City of Tyler would have been aware of the price differential between the TGM Exhibit B Customers and all other customers on the Tyler IDS.
126. Entex did not notify the City of Tyler regarding its criteria for offering service to customers pursuant to a Complementary Contract and a Backup Contract.
127. The Franchise Agreement in effect for the City of Tyler during the review period required that Entex inform the City of Tyler regarding its criteria for determining which customer was eligible for a Complementary Contract and Backup Contract.
128. Entex's criteria for filing interruptible tariffs pursuant to section 104.003 is inconsistent.
129. Some of the customers identified as interruptible do not qualify for a negotiated contract pursuant to section 104.003.
130. The tariffs on file do not reflect the option that certain interruptible customers have to acquire natural gas with a Backup Contract with rates approved in Tariff 590.
131. It is reasonable to have Entex refile all of its tariffs to allow the regulatory authorities to assess whether those tariffs should be accepted.

RATE CASE EXPENSE

132. Section 103.022 of the Texas Utilities Code provides for the recovery of rate case expense by a municipality and a utility involved in a ratemaking proceeding.
133. Section 104.051 of the Texas Utilities Code permits the "utility a reasonable opportunity to earn a reasonable return on the utility's invested capital used and useful in providing service to the public."
134. By city ordinance, the City of Tyler ceded ratemaking jurisdiction to the Commission and "intended the relief sought in that docket to be ratemaking in that it would affect and change the compensation received by Entex for sales and service on Entex's Tyler Integrated Distribution System."
135. The Commission has determined that this is a ratemaking proceeding.
136. The City of Tyler has provided testimony and evidence in the record for actual rate case expense of \$1,142,124.94 and estimated future expenses of \$460,000.
137. Entex has provided testimony and evidence in the record for a total of \$1,598,366.93 in rate case expense and estimated future expenses of \$442,000.

138. It is not reasonable that the City of Tyler recover \$14,041.89 associated with the early stages of the negotiations of the Franchise Agreement with Entex.
139. It is reasonable that the City of Tyler recover \$142,490.75 associated with the municipal proceedings prior to Docket No. 9364.
140. The expenses associated with the municipal proceedings were required to ascertain the relationship of the Complementary Contract and the Backup Contract, the differential of gas rates between the TGM Exhibit B Customers and the other customers on the Tyler IDS, and the basis of that differential.
141. It is not reasonable that rate payers of the City of Tyler be required to pay a surcharge of \$142,490.75, associated with the municipal proceedings prior to GUD No. 9364, in order for the City of Tyler to acquire information that Entex should have filed with the regulatory authority.
142. It is reasonable that the City of Tyler be reimbursed by Entex because the City would not have otherwise known of Entex's practices regarding the Complementary Contract and the Backup Contract, the differential of gas rates between the TGM Exhibit B Customers and the other customers on the Tyler IDS, and the basis of that differential.
143. Likewise, it is not reasonable that \$349,253.79 of Entex's rate case expense attributed to July 2000 through January 2003 be recovered from rate payers through a surcharge, because Entex did not disclose its practices regarding the Complementary Contract and the Backup Contract, the differential of gas rates between the TGM Exhibit B Customers and the other customers on the Tyler IDS, and the basis of that differential.
144. It is reasonable for the City of Tyler to recover expenses related to the two district court proceedings emanated from this docket.
145. It is not reasonable for the City of Tyler to recover expenses, \$1,012.50, associated with its communication with the press regarding this docket.
146. It is not reasonable that \$14,445.71 of the City of Tyler's rate case expense attributed to the City Attorney be reimbursed because he is a City of Tyler and he was not separately engage to conduct these proceedings.
147. It is not reasonable that \$119,226.14 of Entex's rate case expense attributed to Entex's General Counsel be reimbursed because he is an Entex employee. His expenses are already paid for by the ratepayer through the cost of service rates.
148. It is not reasonable that \$50,542.86 of Entex's rate case expense attributed appealing the Commission's order of GUD No. 9469 because it is a separate matter.

149. Likewise, it is not reasonable for the City of Tyler to recover any expenses associated with the appeal of GUD No. 9469.
150. As the City of Tyler did not provide its specific expenses associated with GUD No. 9469, it is reasonable to disallow the same amount that Entex expended in that appeal since the City of Tyler has only participated through the filing of an *amicus* brief. To disallow all of the City of Tyler's rate case expenses in this proceeding would not be reasonable.
151. The expenses of Entex associated with issues regarding the City of Tyler's late filed testimony of Rollie Bohall should not be recovered from the ratepayers through a surcharge.
152. Entex's expenses associated with issues regarding the testimony of Rollie Bohall were \$5,190.
153. It is reasonable that the City of Tyler recover no more than \$1,070,933.87 and Entex recover no more than \$1,079,344.14. Thus, combined total rate case expense of \$2,150,278.26 are reasonable.
154. Due to Finding of Fact No. 123 it is reasonable that only \$2,007,787.26 be recovered from the rate payer through a surcharge.
155. It is reasonable that Entex surcharge the customer on a per Mcf basis for a period of 60 months, or until \$2,007,787.26 is recovered.
156. It is reasonable that Entex provide a schedule of recovery to the City of Tyler every 6-months until recovered.
157. It is also reasonable that Entex provide the Commission and the City of Tyler a summary schedule of amounts recovered at the end of the recovery period.
158. The amounts estimated by the parties to complete these proceeding through an appeal to the Supreme Court are \$725,000.
159. The evidence provided to support that request is insufficient and the amount appears to be unreasonable.
160. It is reasonable to require the parties to file a separate docket, either at the Commission or at the municipal level, after the conclusion of all future proceedings related to this case, if they desire to recover any additional expenses related to these proceedings.

CONCLUSIONS OF LAW

1. Entex is a gas utility as defined in Texas Utilities Code (TUC). TEX. UTIL. CODE ANN. §§ 101.003(7) and 121.001 (Vernon Supp. 2004).

2. The Commission has jurisdiction over the subject matter of this case under TEX. UTIL. CODE ANN. §102.001 and 103.001. (Vernon & Supp. 2004).
3. The City of Tyler's decision to allow a utility to recover gas cost through a purchased gas adjustment is discretionary.
4. The Commission's decision, under 16 TEX. ADMIN. CODE § 7.5519 (200), whether to allow a utility to recover gas cost through a purchased gas adjustment clause is discretionary.
5. A tariff may permit, or require, that a utility assign its gas costs.
6. A utility may only include in its purchase gas adjustment clause only its reasonable and necessary gas purchase expenditures.
7. The reasonableness and prudence of a utility's gas purchases pursuant to its purchased gas adjustment clause are subject to a review, and potential refund, in subsequent proceedings.
8. In conducting a prudence review, the following standard is appropriate: The exercise of that judgment and the choosing of that select range of options which a reasonable utility manager would exercise or choose in the same or similar circumstances given the information or alternatives at the point in time such judgment is exercised. *Gulf States Utilities v. Public Utility Comm'n of Texas*, 841 S.W.2d 459, 476 (Tex. App. — Austin 1992, writ denied).
9. The filed rate doctrine prohibits regulated utilities from charging rates for their services other than those properly filed with the appropriate regulatory authority. *Entex. v. Railroad Comm'n of Texas*, 18 S.W.3rd 858, 862 (Tex. App. — Austin 2000, pet. denied).
10. A gas utility may not directly or indirectly charge a person a greater or lesser compensation for a service provided by the utility than the compensation prescribed by the applicable schedule of rates filed under section 102.151 of the Texas Utilities Code. TEX. UTIL. CODE ANN. § 105.055.
11. A rate may not be unreasonably preferential, prejudicial, or discriminatory but must be sufficient, equitable, and consistent in application to each class of customer. TEX. UTIL. CODE ANN. § 104.003.
12. A gas utility may not grant an unreasonable preference or advantage concerning rates or services to a person in a classification. TEX. UTIL. CODE ANN. § 104.004(a).
13. A gas utility may not subject a person in a classification to an unreasonable prejudice or disadvantage concerning rates or services. TEX. UTIL. CODE ANN. § 104.004(b).
14. A gas utility may not establish or maintain an unreasonable difference concerning rates of services between localities or between classes of service. TEX. UTIL. CODE ANN. § 104.004(c).

15. A rate for a pipeline-to-pipeline transaction or to a transportation, industrial, or similar large volume contract customer is considered to be just and reasonable if neither the gas utility nor the customer had an unfair advantage during the negotiations, the rate is substantially the same as the rate between the gas utility and at least two customers of the utility under the same or similar conditions of service, or competition does or did exist with another gas utility, another supplier of natural gas, or a supplier of an alternative form of energy. TEX. UTIL. CODE ANN. §104.003(b).

IT IS ORDERED THAT Entex refile all of the tariffs applicable to the Tyler IDS and that the refiled tariffs include information regarding the contracts applicable to each customer, or class of customer, and shall fully disclose all terms and conditions applicable to customers and classes of customers. Specifically, if service is available to a customer, or class of customer, pursuant to more than one tariff, the tariffs shall indicate that fact.

IT IS FURTHER ORDERED THAT Entex shall cease discriminating among its various customers by offering special contracts members of one class at preferential rates.

IT IS FURTHER ORDERED THAT Entex is authorized to recover a surcharge on its rates charged to ratepayers in the City of Tyler on a per Mcf basis for a period of 60 months, or until \$2,007,787.26 is recovered. **IT IS FURTHER ORDERED** that Entex provide a schedule of recovery to the City of Tyler every 6-months until recovered. It is also reasonable that Entex provide the Commission and the City of Tyler a summary schedule of amounts recovered at the end of the recovery period

IT IS FURTHER ORDERED THAT all relief not specifically granted herein is **DENIED**.

SIGNED this ____ day of May, 2005.

RAILROAD COMMISSION OF TEXAS

VICTOR CARRILLO
CHAIRMAN

MICHAEL L. WILLIAMS
COMMISSIONER

ELIZABETH A. JONES
COMMISSIONER

ATTEST

SECRETARY