

**IN THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE**

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IN RE:

ATMOS ENERGY CORPORATION
ACTUAL COST ADJUSTMENT
("ACA") AUDIT

Docket No. 05-00253

**ATMOS ENERGY CORPORATION'S RESPONSE TO
STAFF AUDIT REPORT**

Atmos Energy Corporation ("Atmos" or "Company") provides the following response to the revised ACA Audit Report submitted by the Utilities Division Staff in this docket (the "Audit Report"). The Staff's April 21, 2006 Notice of Filing recites that Staff's preliminary findings were submitted to Atmos, and Atmos' responses to those findings incorporated into Staff's final Audit Report. However, the preliminary findings shared with Atmos did not include any of the discussion, conclusions, or recommendations concerning the Company's asset management agreement that appeared in the final Audit Report. This filing, therefore, represents the first opportunity Atmos has had to respond to the Audit Report's conclusions and recommendations concerning the Company's asset management.

As discussed more thoroughly below, Staff's recommendations are not well-founded. However, regardless of the merits of the issues Staff has raised, the matter should not be taken up in this docket. The Authority may not reach a determination as to Staff's recommendations without first affording the parties the opportunity to develop a record on the issues. Because any determination in this matter will represent new policy for the Authority that will impact the industry as a whole, a rulemaking proceeding, such as the existing Generic Gas Industry Docket, is the required forum for consideration of the issues raised by Staff.

I. **STAFF'S CONCLUSIONS AND RECOMMENDATIONS CONCERNING ATMOS ASSET MANAGEMENT ARE OUTSIDE THE SCOPE OF THE ACA AUDIT AND SHOULD NOT BE CONSIDERED AS PART OF THIS DOCKET.**

The objective of an ACA audit is to ensure that the Company's calculations of the gas costs it has incurred and the amounts it has recovered from consumers are materially correct.¹ Despite specifically acknowledging this limited scope in the Audit Report, Staff included in its final version discussion, conclusions, and recommendations regarding the Company's asset management agreement with Atmos Energy Marketing, LLC ("AEM").² These conclusions and recommendations do not find or suggest that Atmos has violated any existing standard or rule of the Authority, but instead recommend that the Authority implement certain policy changes to the manner in which the Authority regulates asset management and affiliate relationships in the future. Staff's recommendations are not based solely on its review of Atmos' agreement with AEM, but also on sometimes inaccurate comparisons with other gas companies' asset management arrangements.

An ACA audit, which is not a contested case, is not the proper forum for such policy recommendations, especially in light of the limited opportunity Atmos has been given to discover and respond to the various statements and positions by Staff. As the Audit Report acknowledges, the function of Staff audits is to ensure compliance with established Authority rules and orders; the audits do not give Staff the right to conduct a yearly re-examination of the standards and policies set forth by the Authority. Many of the rules and orders Staff is charged with enforcing through audits resulted from fully-litigated hearings which included cross-examined testimony from numerous expert witnesses within the particular industry. Staff's requests in previous dockets for authority to retain expert consultants to advise on asset management issues in particular raises the

¹ Audit Report p. 4.

² The Audit Report mistakenly refers to this entity as Atmos Energy Management.

question as to whether additional study should be completed before policy recommendations are made. In addition, as the Authority has implicitly recognized in previous dockets, Staff cannot use audits to disallow past amounts based upon a recommended change in policy or standard going forward.³ See Tenn. Code Ann. § 65-4-117 (defining the TRA's regulatory authority as prospective only, and granting the TRA the power to, "[a]fter hearing, by order in writing, fix just and reasonable standards, classifications, regulations, [or] practices . . . to be furnished, imposed, observed and followed **thereafter** by any public utility.")

Although it is inappropriate to insert Staff policy recommendations into any audit, Staff's inclusion of asset management recommendations in the Audit Report in this case is particularly arbitrary. Unlike the arrangements in place for the other gas companies Atmos is compared to, AEM does not manage Atmos' gas supply procurement, but instead manages only the Company's pipeline capacity and storage assets.⁴ Therefore, Atmos' agreement with AEM has absolutely no impact on or relationship to the subject of the audit, Atmos' gas supply costs.

Finally, the parties have not had the opportunity to present evidence regarding Staff's conclusory statements and recommendations in order to develop a record that could form the basis of an Authority decision. See Office of the Attorney General v. Tennessee Regulatory Auth., 2005 Tenn. App. LEXIS 745 at * 38 – 40 (Tenn. Ct. App. Nov. 29, 2005) (finding Authority abused its discretion by deciding a disputed issue without giving the parties the opportunity to develop the record through a contested case). It is evident from the brief discussion included in the Audit Report that Staff's recommendations are based on fundamental misconceptions regarding Atmos' agreement with AEM. For example, Staff compares the lump sum payment under the AEM

³ See Audit of Nashville Gas' Incentive Plan Account, Docket No. 03-00489, Audit Report p. 13 and 10/1/04 Order; Audit of Chattanooga Gas ACA Account, Docket No. 03-00516, 12/13/04 Trans. of Proceedings pp. 59-60.

⁴ The two gas companies to which Staff compares Atmos are Nashville Gas Company and Chattanooga Gas Company. Nashville Gas currently bundles its gas supply and asset management through third parties. Chattanooga Gas bundles its supply and asset management through an affiliate.

agreement with those for other gas companies and concludes that the AEM amount “appears to be extremely low.”⁵ However, Staff failed to recognize that the agreements for the other two gas companies involve both asset management and supply procurement, whereas the AEM agreement is an “unbundled” contract for asset management only. Furthermore, one of the other arrangements is a profit sharing agreement which does not insulate ratepayers from the economic risks of engaging in the volatile asset management market, as the AEM agreement does. It is clear that in comparing the AEM fee with the proceeds of other asset management arrangements, Staff is comparing apples and oranges.⁶ In the absence of a full opportunity to develop a complete record on these issues of dispute, the Authority may not consider Staff’s recommendations in this docket. See Office of Attorney General, 2005 Tenn. App. LEXIS 745 at * 38 – 40.

II. **THE AUTHORITY SHOULD ADDRESS THE ISSUE OF ASSET MANAGEMENT REGULATION IN AN INDUSTRY-WIDE PROCEEDING.**

It is obvious from a review of the most recent incentive plan and ACA audits for the three gas companies that Staff believes asset management is an area that should be subject to some additional degree of Authority regulation beyond the rules and policies currently in place. It is also clear that Staff may not have had the opportunity to be exposed to all aspects of asset management within the natural gas industry: Staff has previously acknowledged the complexity of the issues involved, and has on more than one occasion requested assistance in the form of an expert consultant. The inaccuracies and faulty assumptions in the Audit Report in this case reveal a misunderstanding of the AEM agreement which could likely have been avoided had Staff raised

⁵ Audit Report p. 15.

⁶ The Company would also point out that it is already subject to affiliate rules previously approved by the Authority in connection with the Company’s Performance-Based Ratemaking Mechanism (PBR) that do not apply to either Nashville Gas or Chattanooga Gas. Staff’s suggestion in the audit report that revisions of these rules should be submitted to provide additional guidance in the Company’s selection of an asset manager is neither warranted or justified inasmuch as such standards are already sufficiently clear. If anything, the asset management agreement in place complies with the affiliate standards approved by the Authority because it was entered into only after bids were solicited through a competitive bidding process.

the issue in a more appropriate forum. If the Authority agrees with Staff that additional regulation should be imposed on the industry in this area, at the very least, any such regulation must be accomplished through a contested case proceeding which allows the parties to conduct discovery and present expert testimony on the matter. See Office of the Attorney General, 2005 Tenn. App. LEXIS 745 at * 38 – 40. Indeed, it appears that this is the method the Authority has decided to pursue with regard to Nashville Gas.⁷

However, rulemaking, and not adjudication, is the preferable way for agencies to promulgate new policies, rules, or standards that will govern the future conduct of those subject to its authority. Tennessee Cable Assoc. v. Tennessee Pub. Serv. Comm'n, 844 S.W.2d 151, 161-62 (Tenn. Ct. App. 1992). By contrast, adjudication through contested cases is the process by which an agency applies existing policies and rules to a particular utility under a particular set of facts. Id. Generally, rulemaking is required if the agency's determination is intended to be applied uniformly to a broad segment of a regulated industry, rather than to an individual entity only, or if the determination reflects new administrative policy that has not been previously expressed in any official and explicit order or rule. Id. at 162.

The practice of asset management outsourcing arrangements by gas utilities has been prevalent since the mid to late 1990s,⁸ but the Authority has yet to examine this practice by regulated utilities from a policy standpoint. The Authority's ultimate determination on whether additional regulation is necessary in this area, and if so, what form it should take, will impact all natural gas companies in Tennessee, not just Atmos. Therefore, this matter falls into the category of cases that must be decided through a rulemaking proceeding such as the Generic Gas Industry

⁷ See 9/6/05 Order in Audit of Nashville Gas Incentive Plan Account, Docket No. 04-00290.

⁸ The Federal Energy Regulatory Commission's Order 636 unbundling the interstate pipeline industry ultimately facilitated the ability of local distribution companies to more effectively utilize assets such as upstream capacity and storage.


Docket No. 05-00046 ("Generic Docket"), and not through an adjudicatory proceeding such as a contested case.

Asset management was identified early on in the Generic Docket as a topic on which additional expertise was needed. It was anticipated that information could be shared through workshops and recommendations formulated before determining whether rulemaking proceedings would be necessary. It was suggested in that docket that an industry expert be brought in to conduct informational sessions for the companies and Staff. If the Authority wishes to impose additional regulation in the area of asset management, it should be done through a deliberate and open industry-wide process that allows for full opportunity for the sharing of information and debate. Atmos requests that any future regulation in this area be accomplished through the Generic Docket or a similar rulemaking proceeding.

III. CONCLUSION.

The conclusions and recommendations concerning Atmos' asset management Staff has included in the Audit Report reveal a lack of understanding by Staff of both Atmos' agreement with AEM and the complex issues surrounding asset management in the natural gas industry. The Authority may not take up Staff's recommendations until the parties have been afforded a full opportunity to develop a complete record on the disputed issues. Because the Authority does not currently have policies or rules in place governing asset management arrangements, and because any newly established regulation on those issues would impact all natural gas companies in Tennessee, the matter should be taken up in the Generic Docket or similar rulemaking proceeding, rather than through a contested case.

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing has been served via U.S. Mail, postage prepaid, upon the following this the 10th day of May, 2006:

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