**Before the**

**TENNESSEE REGULATORY AUTHORITY**

**IN RE:**

**PETITION OF TENNESSEE-ATMOS ENERGY COPORATION**

**DOCKET NO. 05-00258**

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**REBUTTAL**
**TESTIMONY**
**OF**
**TERRY BUCKNER**

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**August 18, 2006**

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

**IN RE:**

**PETITION OF TENNESSEE-ATMOS ENERGY COPORATION**

**DOCKET NO. 05-00258**

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## AFFIDAVIT

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I, Terry Buckner, Regulatory Analyst, for the Consumer Advocate Division of the Attorney General's Office, hereby certify that the attached Rebuttal Testimony represents my opinion in the above-referenced case and the opinion of the Consumer Advocate Division.

Terry Buckner
TERRY BUCKNER

Sworn to and subscribed before me
this 17th day of August, 2006.

Emily Knight
NOTARY PUBLIC

My commission expires: Sept. 22, 2007

EMILY KNIGHT
NOTARY PUBLIC AT LARGE
DAVIDSON COUNTY, TENN.
My Commission Expires SEPT. 22, 2007

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**Q. Please state your name for the record.**

A. My name is Terry Buckner.

**Q. By whom are you employed and what is your position?**

A. I am employed by the Consumer Advocate and Protection Division ("CAPD") in the Office of the Attorney General for the state of Tennessee ("Office") as a Regulatory Analyst.

**Q. What is the purpose of your testimony?**

A. The purpose of my testimony is to rebut the written direct testimonies of Atmos Energy Corporation ("Atmos") before the Tennessee Regulatory Authority ("TRA").

**Q. Please comment on the Atmos testimony in this docket.**

A. A financial summary of the testimony finds that Atmos is proposing a rate increase in this docket.[1] Atmos' proposal is particularly ironic in light of the protracted process to convene this proceeding and Atmos' original position sought that the proceeding be entirely "dismissed."[2] Nevertheless, Atmos has adopted an

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[1]Atmos witnesses, John Paris direct testimony, p. 15, lines 12-13 and Pat Childers direct testimony, page 15, lines 4-22.

[2]Atmos Energy Corporations's Response to Report and Recommendation of Investigative Staff of May 10, 2006, page 9.

attrition year ended September 30, 2007 for their forecast of earnings. CAPD Exhibit TB-1 compares the forecast calculated by Atmos with an appropriate rate-making 2007 forecast after adjustments. Additionally, a restatement of the CAPD 2006 forecast is shown for comparative purposes. In my opinion, Atmos' forecasted results for the attrition year ended September 30, 2007 are significantly flawed for rate making purposes.

**Q. Please describe your issues with Atmos' forecast.**

A. Mr. Dan McCormac will rebut the operating revenue margins and Dr. Steve Brown will rebut the capital structure and rate of return issues. My issues with Atmos' forecast are: (1) Labor Expense; (2) Long Term Incentive Plan ("LTIP") Expense; (3) Pension Expense; (4) Uncollectible Accounts Expense; (5) Environmental Control Costs; (6) Rate Case Expense; (7) Operations and Maintenance Expense Growth Rate; (8) Depreciation Expense; (9) Taxes Other Than Income; (10) Income Taxes; (11) Rate Base; and (12) NOI adjustments.

**OPERATIONS AND MAINTENANCE EXPENSES:**

**Q. What are the issues with Atmos' forecast of Labor Expense?**

A. Atmos forecast of labor is overstated by $416,411.[3] Atmos claims its labor forecast is based on a test period of eight months actual (October 2005-May 2006) and four months projected (June 2006-September 2006) grown by 3.5%.[4] Atmos states that "employee levels have remained relatively flat since September 30, 2005."[5] Also, "Atmos does not anticipate any other material changes to employee levels at this time."[6] Yet, Atmos did not provide a calculation by employee of their labor expense, the number of employees, or the number of overtime hours by employee. Based on the responses of Atmos, the fiscal year 2005 labor expense was $2,775,896.[7] Conversely, the CAPD did calculate labor using actual employee levels as of March 31, 2006, the latest actual wage rate per employee, the latest available overtime hours by employee, and the latest capitalization rate. In effect, the CAPD forecasted 2006 labor was increased by an annual growth rate of 3.5%. Again, all of the

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[3]CAPD work paper, EXHIBIT TB-1, Line 4, ADJ. #2, Index of Rebuttal Work Papers, Page 1.

[4]Atmos Direct Testimony, Schedule GW-3, Line 1.

[5]Atmos Direct Testimony, Greg Waller, Page 8 of 12, lines 14-15.

[6]Atmos Direct Testimony, Greg Waller, Page 8 of 12, lines 18-19.

[7]Source files: Q10DTB093end05, Summary of DR #11, #18, #19, #21, and MFR #31.

direct labor calculations were based on the discovery responses received from Atmos. Based on the CAPD calculations, labor expense for the attrition year 2007 amounts to $2,978,354.[8] When compared to Atmos labor expense amount of $3,394,765, an overstatement of $416,411 is the result.

The CAPD number is more reasonable because: (1) an empirical calculation was performed in detail; (2) it compares reasonably to the 2005 labor amount at a reasonable growth rate; and (3) all source documents are shown. Conversely, Atmos' labor forecast is unsupported and is approximately 22% higher than the actual 2005 labor amount, a growth rate that far exceeds a reasonable level.

Therefore, the Atmos' forecasted labor expense amount should be rejected as unjust, unreasonable, and without substantiation.

**Q. What are the issues with Atmos forecast of LTIP?**

A. Atmos is forecasting $444,447[9] for the fiscal year ended September 2007 in its Operations and Maintenance Expense for the "incentive plan."[10] Over the last ten years, Atmos has paid or will pay

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[8]CAPD work paper, E-PAY 5, Index of Rebuttal Work Papers, Page 12.

[9]CAPD work paper, E-LTIP, Index of Rebuttal Work Papers, Page 69, CAPD work paper, EXHIBIT TB-1, Line 5, ADJ. #3, Index of Rebuttal Work Papers, Page 1.

[10]Atmos response to TRA Data Request, MFR #38.

over $42 million in LTIP.[11] Again, the LTIP payroll is based on **one** sole performance measure: "Earnings Per Share."[12] Consequently, all of the incentive payroll is based on the financial operating results of Atmos and all LTIP employees receive the compensation regardless of the individual employee's performance. The TRA has found in a previous docket[13] that 50% of LTIP should be borne by the shareholders. However, unlike Atmos' more onerous LTIP plan, the incentive plan in that docket was not based **solely** on Earnings Per Share. Once more, because there is no mechanism under the LTIP for Atmos' ratepayers to share in these increased earnings, Atmos' employees and shareholders will reap all of the financial rewards of higher earnings. The LTIP proposed by Atmos is of no benefit to the ratepayers. This is illustrated by the following: If Atmos' employees are successful in increasing the company's earnings, even to the point of earning above the authorized rate of return set by the TRA, Atmos will reward its employees for this effort through the LTIP. In such a case, ratepayers would not only be unreasonably burdened by the over -earnings, but under Atmos' proposal they also would have to pay an "over earnings surcharge" in the form of the LTIP. The CAPD does

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[11]Atmos response to TRA Data Request, MFR #38, Atmos 2nd Joint Discovery Response DR #3.

[12]Atmos response to TRA Data Request, MFR #38.

[13]TRA Docket #96-00977, dated February 19, 1997, page 12.

not object if the company wants to reward its employees for increasing its earnings from regulated operations; however, the cost of these rewards should be charged to those that benefit from the LTIP — the company's shareholders — not the ratepayers. Also, it is interesting to note that despite the gloomy earnings forecast submitted by the company, Atmos has forecasted a 40%[14] increase in LTIP expense for the 2007 fiscal year in Tennessee. A stark contrast in what the company is forecasting to pay for increased earnings per share and Atmos' projected decline in 2007 earnings in Tennessee.

Additionally, Atmos has capitalized a large portion of LTIP costs. Based on the data provided by Atmos, the rate base portion of the LTIP has also been excluded.[15] Further, $22,827 of depreciation expense associated with the LTIP has been excluded for the attrition year.[16]

Therefore, all of the costs associated with the Atmos LTIP should be excluded for setting rates because the costs are unjust and unreasonable to the ratepayers.

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[14]CAPD work paper, 2006 E-LTIP, replacement Page P173 amount of $318,398 and CAPD work paper, 2007 E-LTIP amount of $444,447, Index of Rebuttal Work Papers, Page 69.

[15]CAPD work paper, RB-LTIP, Index of Rebuttal Work Papers, Page 139.

[16]CAPD work paper, E-LTIP-DEP, Index of Rebuttal Work Papers, Page 76.

**Q. Please explain the exclusion of Pension Expense from the Atmos forecast.**

A. The CAPD has adopted the Pension funding amount of zero as disclosed in the latest Form 10-K report filed by Atmos with the United States Securities and Exchange Commission ("SEC").[17] Further, Atmos' most recent Actuarial Valuation Report as of October 2005 indicates a FAS 87 funded percentage of 114.5% for January 1, 2004 and 103.5% for January 1, 2005.[18] The Employee Retirement Income Security Act ("ERISA") of 1974 indicates funded percentages of 126.2% as of January 1, 2004 and 125.5% at January 1, 2005.[19] Consequently, under both financial and governmental funding standards, Atmos' pension plan is more than fully funded at this time and plans no funding for 2006 or 2007.[20] Historically, in Tennessee, only actual pension contributions have been recognized for setting rates.[21]

Atmos records pension expense in accordance with Financial Accounting Standard ("FAS") No.87. Tennessee's portion of the

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[17]Atmos 2005 10K, page 92.

[18]Atmos response to TRA Data Request, MFR #37, Page MS-1.

[19]Atmos response to TRA Data Request, MFR #37, Page MS-9.

[20]Atmos response to TRA Data Request, DR #27.

[21]TRA Docket #96-00977, Order dated February 19, 1997, pages 13 and 14. TRA Docket #99-00994, Order dated, July 18, 2000, pages 4-5.

FAS 87 pension expense for the attrition year is estimated to be $417,131[22] and was excluded for rate-setting purposes in Tennessee.

**Q. What is the issue with Atmos' forecast of Uncollectible Accounts Expense?**

A. Atmos has forecasted $351,679 for the attrition year.[23] The most recent reported uncollectible expenses on base revenues were examined. Since uncollectible expense related to gas costs can be recovered through the Purchased Gas Adjustment ("PGA") in compliance with the TRA's ruling in Docket #03-00209, the only costs that should be included in the cost of service is the portion of uncollectible expense related to base rates. As a result, uncollectible expense should be adjusted to exclude the "gas cost" portion of uncollectible expense.

Therefore, Atmos forecasted amount is not just and reasonable and should be reduced by $255,919[24] to the CAPD forecasted amount of $95,760.

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[22]Atmos 2nd Joint Discovery response, DR #5.

[23]Atmos Schedule GW-3, Line 17, Column C.

[24]CAPD work paper, EXHIBIT TB-1, Line 7, ADJ. #5, Index of Rebuttal Work Papers, Page 1.

**Q. Please discuss your issue with Environmental Control Costs for Atmos' forecast attrition year.**

A. Atmos is seeking to recover an estimated $1,913,407 in costs related to environmental control requirements that were mandated by various federal and state agencies.[25] Atmos proposes to amortize the nearly $2 million of costs over a three year period beginning October 1, 2006, which results in $637,802[26] in additional operations and maintenance expenses for Atmos' attrition year forecast. Atmos cites authority for this accounting treatment in Tennessee Public Service Commission ("TPSC") Docket #94-02529, dated October 4, 1994. In this docket, five underground storage tank sites in Tennessee were identified as environmental cleanups. The company estimated that the total costs ranged from $70,000 to $4,250,000.

The company proposed that the disposition of the costs would be reserved for and determined in the Company's next application for adjustment of its rates and charges, which was TPSC Docket #95-02258. Notwithstanding, the Company made no disposition proposal in that docket. Further, the amount subject to amortization has never been audited for veracity of which approximately 35% is estimated for the attrition year. It is not known if the additional environmental

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[25]Atmos Direct Testimony, Greg Waller, page 6, lines 4-22.

[26]Atmos Direct Testimony, Schedule THP-4, work paper, WP THP-4-1.

remediation costs will be performed within the company or by external sources. If internally borne, then the labor and employee benefit costs have already been included in the forecast.

Therefore, the amortization of the deferred costs should not begin until the total actual costs are completed, known, and verified. Additionally, such costs should be amortized over an appropriate amortization period so as not to unreasonably burden ratepayers. The CAPD is of the opinion that ten years would be a reasonable period over which to amortized these costs. Consequently, the $637,802[27] in amortized environmental control costs is excluded from operations and maintenance expenses for Atmos' 2007 attrition year.

**Q. Please discuss your issue with Rate Case Expense for Atmos' forecast attrition year.**

A. Atmos projects this proceeding will cost $165,000.[28] The company proposes to amortize the cost over a three year period starting at October 1, 2006. The unamortized balance is included in the company's forecasted rate base for the attrition year. Given that the company has not had a rate case in ten years,[29] the rate case cost in

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[27]CAPD work paper, EXHIBIT TB-1, Line 8, ADJ. #6, Index of Rebuttal Work Papers, Page 1.

[28]Atmos Direct Testimony, Thomas H. Peterson, Page 5, Lines 13-16.

[29]Atmos Direct Testimony, John Paris, Page 14, Lines 22-24.

this proceeding should be amortized over a ten year period. As a result, rate case expense for the attrition year should be reduce by $38,500.[30]

**Q. What are the issues with Atmos' Operations and Maintenance Expense growth rate?**

A. Atmos has forecasted total Operations and Maintenance Expenses of $16,410,059[31] for the attrition year ended September 2007. Atmos has reported total Operations and Maintenance Expense of $14,505,543[32] to the TRA for the latest twelve months to date ended May 2006. In effect, Atmos has forecasted an Operations and Maintenance Expense growth of over 13% over the next sixteen months. Obviously, a portion of this growth is due to their environmental costs proposal, their reorganization proposal, and their proposed rate case amortization amount. Netting those proposed cost amounts reduces the growth rate to over 6%. This rate, in and of itself, exceeds traditional growth rate methods using inflation and customer growth. Atmos forecasted their fiscal year 2007 Operations and Maintenance Expense amount by growing their forecasted fiscal

[30]CAPD work paper, EXHIBIT TB-1, Line 9, ADJ. #7, Index of Rebuttal Work Papers, Page 1.

[31]Atmos Direct Testimony, Schedule THP-4, work paper, WP THP-4, Lines 12, 17-19.

[32]Atmos May 2006 TRA 3.03 Surveillance report, Lines 7-11.

year 2006 amount of $14,877,384 by 3.5%.[33] Since the company is apparently unable to provide in their testimony their forecasts of Operations and Maintenance Expenses by account,[34] a proper reconciliation of the expense growth differences is more difficult. However, by reducing the forecasted September 2006 base period or test period amount to the latest actual twelve months to date generates a more just and reasonable growth rate of 3.6%, which corresponds more reasonably to inflation and customer growth.

Therefore, an adjustment of $340,072[35] in reduced Operations and Maintenance Expense growth is just and reasonable.

**DEPRECIATION EXPENSE:**

**Q. Please discuss your issue with Depreciation Expense for Atmos' forecast attrition year.**

A. Atmos proffers a depreciation study from 2002,[36] which recommends the Equal Life Group ("ELG") procedure for calculating depreciation expense for the Shared Service ("SSU") plant in service. The depreciation expense from SSU plant in service is allocated to

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[33]Atmos Schedule GW-3, Line 21, Column A.

[34]Atmos 2nd Joint Discovery Response, DR #6.

[35]CAPD work paper EXHIBIT, TB-1, Line 10, ADJ. #8, Index of Rebuttal Work Papers, Page 1.

[36]Atmos Exhibit DSR-3.

various Atmos state jurisdictions. The "proposed"[37] increase in depreciation expense for Tennessee operations for the attrition year amounts to $782,436.[38] Increasing depreciation rates, reduces the earnings of a public utility for the short term, but enables the utility to retain the cash flow for other uses. Additionally, Atmos states that roughly one fourth of its jurisdictions have approved the ELG procedure.[39] However, other jurisdictions have rejected the ELG procedure.

Recently in a rate docket for another Atmos state jurisdiction, Georgia, Atmos proposed the ELG depreciation procedure, an increase in the SSU depreciation rates, but a decrease in the overall state specific composite depreciation rate.[40] The state commission rejected the ELG procedure, disallowed the increase in the SSU depreciation expense and reduced Atmos' composite depreciation rate by 38%.[41]

As an observation, a comparison of the current depreciation rates for Atmos in Tennessee and the recently ordered Atmos

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[37]Atmos Direct Testimony, Thomas H. Peterson, Page 3, Line 29.

[38]Atmos work paper WP THP 7-1 (1,661,319 minus 878,883).

[39]Atmos Direct Testimony, Donald S. Roff, Page 17, Lines 19-20.

[40]Georgia Public Service Commission Docket #20298-U, Order Dated December 20, 2005, Pages 12-14.

[41]Ibid.

depreciation rates in Georgia, state specific plant in service and state specific accumulated depreciation balances is provided in the CAPD work papers.[42] By simply applying the recently approved depreciation rates in Georgia to Tennessee's Plant in Service balance as of March 31, 2006 results in decreasing annual depreciation expense by nearly $5.3 million. Therefore, an independent depreciation study is recommended for the TRA's consideration.

At a minimum, the increase in SSU depreciation of $782,436 should be rejected as not just and reasonable and has been excluded for the attrition year.

Based on the discovery responses of Atmos, total Depreciation Expense net of the LTIP exclusion and the SSU depreciation rate increase exclusion amounts to $11,706,765.[43] As a result, Atmos' forecasted depreciation expense is reduced to a just and reasonable level by $813,111, including the previously mentioned $22,827 of LTIP depreciation expense.[44]

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[42]CAPD work papers, E-DEPCOMP AND E-DEPCOMP1, Index of Rebuttal Work Papers, Pages 78-79.

[43]CAPD work paper, E-DEP, Index of Rebuttal Work Papers, Page 70.

[44]CAPD work paper, EXHIBIT TB-1, Line 12, ADJ. #9, Index of Rebuttal Work Papers, Page 1.

**TAXES OTHER THAN INCOME:**

**Q. Please describe your issues of Taxes Other Than Income for the forecasted attrition year?**

A. CAPD work paper T-OTAX0[45] provides a summary of the calculation of Taxes Other Than Income ("Other Taxes").

Other Taxes for the attrition year are: (1) Property Taxes; (2) the TRA Inspection Fee; (3) Payroll Taxes (FICA, FUTA, and SUTA); (4) State Franchise Tax; (5) State Gross Receipts Taxes; and (6) Other General Taxes. Atmos' forecast of Other Taxes is $766,088[46] greater than the CAPD forecast for the 2007 fiscal year. Four of the Other Taxes categories have significant differences.

**Q. Please explain the difference in the calculations of Property Taxes.**

A. CAPD work paper T-OTAX1[47] provides a historical summary of property taxes paid by Atmos, their gross assessment values, their composite tax rate, and their reported rate base amounts. This schedule reflects an increase in the property taxes due by Atmos for the years 2004-2005. The gross assessment value for the years 2006

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[45]CAPD work paper, E-OTAX0, Index of Rebuttal Work Papers, Page 80.

[46]CAPD work paper EXHIBIT TB-1, line 13, ADJ #10, Index of Rebuttal Work Papers, Page 1.

[47]CAPD work paper, E-OTAX1, Index of Rebuttal Work Papers, Page 81.

and 2007 also indicates increased amounts. Consequently, the forecasted tax amounts for 2006 and 2007 are approximately $2.7 million and $2.75 million, which are based on the actual gross assessment values for the years 2005 and 2006 at the 2005 composite tax rate.

Atmos forecasted $2.8 million in Property Taxes for the forecast year 2007.[48] However, there is no calculation provided by the company as a basis for their number.

Therefore, $60,493 in property taxes should be reduced from Atmos' forecast.

**Q. Please explain the issue with the calculation of Payroll Tax Expense.**

A. A summary of Payroll Taxes is prepared in CAPD work paper T-OTAX3.[49] Payroll Taxes were calculated using the latest actual wage rates grown by 3.5% per employee for a normalized fiscal year ending September 30, 2007 at the current payroll tax rates subject to the taxable wage bases per employee. The capitalized portion of payroll taxes was deducted from the total payroll tax calculation to arrive at the attrition year Payroll Tax Expense of $149,993.

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[48]Atmos 2nd Joint Discovery Response, DR #11, Line 2.

[49]CAPD work paper, E-OTAX3, Index of Rebuttal Work Papers, Page 83.

Atmos has forecasted an amount of $398,605 for the attrition year 2007.[50] Again, there is no calculation provided by the company as a basis for their number. Though, it appears that the company did not capitalize any portion of their payroll taxes. This is inconsistent with the company's historical treatment of payroll taxes and contrary to the Federal Energy Regulatory Commission's ("FERC") Uniform System of Accounts ("USOA").[51]

Therefore, Atmos' forecast of payroll taxes should be reduced by $248,612.[52]

**Q. Please explain the issue with the calculation of Gross Receipts Taxes.**

A. CAPD work paper T-OTAX7[53] provides a calculation of State Gross Receipts Tax for the attrition year 2007. The CAPD amount is based on forecasted gross receipts, forecasted state Franchise Tax, and forecasted state Excise Tax amounts. The total net Gross Receipts Tax for the attrition year is $1,478,381. Again, there is no calculation provided by the company as a basis for their number

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[50]Atmos 2nd Joint Discovery Response, DR #11, Line 1.

[51]Part 201, SUBCHAPTER F, Gas Plant Instructions, Section 3(2), Page 561.

[52]CAPD 2007 Exhibit, Schedule 5, line 3.

[53]CAPD work paper, E-OTAX7, Index of Work Papers, Page 92.

resulting in a difference of $338,458.

Therefore, Atmos' forecast of gross receipts taxes should be reduced by $338,458.[54]

**Q. Please describe the other issues with Atmos' calculation of Other General Taxes for the forecasted attrition year?**

A. Atmos has included a net $153,789[55] in Other General Taxes. Much of this amount is attributable to an allocation of SSU taxes. It is the CAPD's contention that, ratepayers should be subject to taxes on assets and or revenues derived solely within the jurisdiction of Tennessee. Once more, there is no empirical calculations to document support for this amount.

Therefore, the Other General Tax amount of $153,789 should be excluded as unjust and unreasonable for setting rates.

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[54]CAPD 2007 Exhibit, Schedule 5, line 2.

[55]Atmos 2nd Joint Discovery Response, DR #11, Lines 5, 8, and 10.

**INCOME TAXES:**

**Q. Please describe your issue with Atmos' calculation of Income Taxes for the forecasted attrition year?**

A. Investment Tax Credit ("ITC") amortization of $104,319 as provided by Atmos[56] was omitted from the Atmos forecast. Additionally, permanent tax differences of $52,394[57] were omitted by Atmos in their tax calculation. The CAPD recognized these amounts in their income tax calculation.[58]

Therefore, Atmos' forecast of income taxes is overstated by $124,871. Accounting for the interest synchronization, weighted debt costs differences, taxable income differences, and Atmos tax omissions results in a net increase in income taxes of $3,094,384.[59]

**RATE BASE:**

**Q. Please summarize your issues with the calculation of Rate Base items in the attrition year forecast for Atmos.**

A. CAPD work paper Exhibit TB-1 summarizes the results of the rate base calculations. The following significant differences will be

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[56]Atmos response to TRA Data Request, DR #30f.

[57]Ibid.

[58]CAPD 2007 Exhibit, Schedule 6, lines 9 and 15.

[59]CAPD work paper, EXHIBIT TB-1, Line 14, ADJ. #11, Index of Rebuttal Work Papers, Page 1.

addressed: (1) Plant in Service, (2) Working Capital, (3) Depreciation Reserve ("Accumulated Depreciation"), and (4) Accumulated Deferred Taxes.

**Q. Please discuss your issue with Atmos' calculation of Plant in Service for the forecasted attrition year?**

A. Atmos' 13 month average Plant in Service balance is $2,739,522[60] larger than the CAPD's calculation. Atmos' average amount of Plant in Service is shown in work paper WP-THP 7-5.[61] The CAPD's calculation is the culmination of actual plant in service balance at March 31, 2006 by account, by company and service area, and with forecasted monthly plant additions and retirements as provided by Atmos.[62] After comparing Atmos' work paper with the CAPD's calculations, adding the forecasted monthly additions as provided in discovery by Atmos to the actual March 2006 beginning balance for Company 93 (Tennessee) through September 2006, results in an Atmos' overstatement of $3.6 million. However, this overstatement declines in the 13 month average to approximately $2.2 million for the attrition year. This difference when combined with a

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[60]CAPD work paper, EXHIBIT TB-1, Line 26, ADJ #14, Index of Rebuttal Work Papers, Page 1.

[61]Atmos Direct Testimony, work paper WP-THP 7-5, Page 17 of 27, Row #14, Column l.

[62]CAPD work papers, RB-PLANT, Index of Rebuttal Work Papers, Pages 94-128.

LTIP Plant in Service disallowance of approximately $.6 million results in an average Plant in Service overstatement of $2.7 million.

The CAPD number is more reasonable because an empirical calculation was performed in detail and all source documents are shown. Conversely, Atmos' Plant in Service forecast is unsupported.

Therefore, the Atmos' forecasted Plant in Service amount should be rejected as unjust, unreasonable, and without substantiation.

**Q. Please discuss your issue with Atmos' calculation of Working Capital for the forecasted attrition year?**

A. Atmos has elected to include only prepayments in their calculation of Working Capital. Certainly, the use of cash paid before services are rendered or recognized does occur, but that is only one side in the development of an appropriate amount for inclusion in rate base. There are many activities in which services are rendered before payment such as: the payment of an invoice for materials or services received or performed; the recognition of a liability for the accrual of taxes; the payment of employee labor, etc. These "lags" in cash payments have not been accounted for in their Working Capital amount. Additionally, no lead-lag study was performed by the company to calculate an appropriate Working Capital amount. Also, the Virginia and Georgia regulatory agencies have found that the level of cash working capital should be zero for Atmos operations in those states in the absence of a lead-lag study.[63]

Therefore, absent the performance of a lead-lag study, the Working Capital amount of $861,072[64] is excluded from the 2007 forecast.

**Q. Please discuss your issue with Atmos' calculation of Depreciation Reserve ("Accumulated Depreciation") for the forecasted attrition year?**

A. Atmos' 13 month average Accumulated Depreciation balance is $414,045[65] smaller than the CAPD's calculation. Atmos' average amount of Accumulated Depreciation is shown in work paper WP-THP 7-5.[66] The CAPD's calculation is the culmination of the actual Accumulated Depreciation balance at March 31, 2006 by account, by company and service area, and with forecasted monthly depreciation,

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[63]Georgia Public Service Commission Docket No. 20298-U, Order on Reconsideration and Final Order acted on December 20, 2005, page 10. Virginia State Corporation Commission, Docket No. 2003-00507, Final Order, dated January 7, 2005.

[64]CAPD work paper, EXHIBIT TB-1, Index of Rebuttal Work Papers, Page 1, Line #29, ADJ. #17.

[65]CAPD work paper EXHIBIT TB-1, Index of Rebuttal Work Papers, Page 1, Line #33, ADJ #18.

[66]Atmos Direct Testimony, work paper WP-THP 7-5, Page 20 of 27, Row #14, Column l.

costs of removals, and retirements as provided by Atmos.[67] After comparing Atmos' work paper with the CAPD's calculations, Atmos failed to use the actual March 2006 ending balance for Company 93 (Tennessee) in its development of a forecasted Accumulated Depreciation through September 2007, which results in an understatement of $.4 million. This difference is net of the LTIP disallowance of approximately $.1 million. Additionally, Atmos has included $419,556[68] as the Accumulated Depreciation effect of the increase in SSU depreciation rates. Since the increase in depreciation rates should be rejected, the $419,556[69] accounting offset to Accumulated Depreciation should not be included as a deduction from rate base.

The CAPD number is more reasonable because an empirical calculation was performed in detail and all source documents are shown. Conversely, Atmos' Accumulated Depreciation forecast is unsupported by actual company amounts.

Therefore, the Atmos' forecasted Accumulated Depreciation amount should be rejected as unjust, unreasonable, and without

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[67]CAPD work papers, RB-DEP RESERVE, Index of Rebuttal Work Papers, Pages 131-136.

[68]Atmos Direct Testimony, Schedule THP-7, Line #24.

[69]CAPD work paper, EXHIBIT TB-1, Line 39, ADJ. #22, Index of Rebuttal Work Papers, Page 1.

substantiation.

**Q. Please discuss your issue with Atmos' calculation of Accumulated Deferred Taxes for the forecasted attrition year?**

A. Atmos' 13 month average Accumulated Deferred Taxes amount is $32,917,653[70] for the attrition year. Atmos identifies accounts[71] 1900, 2820, and 2830 as the sources of their forecast. By adding the company 93 balance with 27.60% of service areas 88, 90, and 91 and 4.07% of company 10, Atmos reported amounts for these accounts as of May 31, 2006 is $38,595,609.[72] Additionally, Atmos reported $37,239,144 to the TRA on line 28 of the 3.03 May 2006 surveillance report. Finally, Atmos indicated through some of their responses that timing differences would grow Accumulated Deferred Taxes balances in the future.[73] Obviously, the company's forecast is not consistent with actual reported balances, inconsistent with discovery amounts, and unsupported with documentation.

Therefore, Atmos forecast of average Accumulated Deferred

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[70]Atmos Direct Testimony, work paper WP-THP 7-5, Page 19 of 27, Row #35, Column l.

[71]Atmos Direct Testimony, work paper WP-THP 7-5, Page 19 of 27, Row #17.

[72]CAPD work paper, RB-DEFTAX, Index of Rebuttal Work Papers, Page 138.

[73]Atmos 1st Joint Discovery Response, DR #30c.

Taxes is understated and should be increased by $6,900,511[74] to the CAPD calculated amount of $39,818,164.

**NET OPERATING INCOME ("NOI") ADJUSTMENTS:**

**Q. Describe your issues with the forecasted NOI adjustments.**

A. Atmos has failed to recognize the NOI adjustment of Allowance for Funds Used During Construction ("AFUDC"). Investor's funds have been reimbursed through the payment of interest to lenders and a return to the stockholders by ratepayers. Atmos, however, as an industry practice takes some of those investor funds and capitalizes them. As a result, the capitalized amounts, which existing rates have already paid for, build rate base requiring more money from ratepayers. The AFUDC adjustment is added back to NOI to prevent the company from recovering the cost of these funds twice.

Therefore, an amount of $235,383[75] should be added to NOI for the forecasted fiscal year ended September 30, 2007.

Additionally, Atmos has calculated interest on customer

[74]CAPD work paper, EXHIBIT TB-1, Page 1, Line 37, ADJ #21, Index of Rebuttal Work Papers, Page 1.

[75]CAPD Direct Testimony work paper, NOI-AFUDC, Index of Rebuttal Work Papers, Page, 141.

deposits at a rate of 7.74%.[76] The tariff rate, however, is 6%.[77] Therefore, Atmos has excess interest expense of $80,132 based on the tariff interest rate times the forecasted attrition year customer deposits balance of $6,511,070.[78]

**Q. Please summarize your issues with Atmos forecast for the attrition year 2007.**

A. After all of the CAPD adjustments to Operating Revenue Margins, Operating Expenses, Depreciation Expense, Other Taxes, Income Taxes, NOI, and Rate Base and applying Dr. Brown's recommended rate of return of 6.56%, a revenue surplus of $12,403,366[79] is the net result.

**Q. Why did you restate the CAPD's forecast for the fiscal year ended September 2006?**

A. There are three reasons for the restatement: (1) additional information obtained through discovery; (2) the impact of Atmos' consolidation plans; and (3) adjustments to correct certain data.

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76 Atmos Direct Testimony, work paper WP THP 1-1, Line 3.

77 Atmos Tariffs, 1st Revised Sheet No. 56, Section 3.5.

78 Atmos Direct Testimony, work paper WP THP 1-1, Line 1.

79 CAPD work paper, EXHIBIT TB-1, Line 47, Index of Rebuttal Work Papers, Page 1.

First, additional information was obtained in the second round of discovery of the company to not only help facilitate the reasonableness of the CAPD's forecast, but also to understand the basis for Atmos' forecast and their 2006 fiscal year test period amounts. Based on the responses of Atmos, the basis for adjustments and identification of the issues were enhanced.

Secondly, the company originally indicated that the Kentucky and Mid-States Divisions were being combined into a single operating division of Atmos.[80] Additionally, the company stated that they would "provide a complete analysis of this impact before filing testimony in this case."[81] Regretfully, the CAPD did not know the impact before direct testimony was filed. Therefore, much of the rate base was recast as well as depreciation expense.

Finally, the following adjustments were made: (1) an amount of $20,453 was wrongly included in account #8210; (2) AFUDC was wrongly subject to income tax rates twice; (3) the work papers for LTIP were updated to reflect information received after the direct testimony was filed; (4) the State Franchise tax amounts were updated and re-calculated; and (5) the work papers for Accumulated Deferred Taxes were updated and re-calculated.

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[80]Atmos Discovery Response, MFR #1, Page 2, section c.

[81]Ibid.

**Q. What is the net result of your restatement of Atmos' earnings for the fiscal year 2006?**

A. The CAPD's original filing in our direct testimony resulted in a $12.4 million rate reduction recommendation. The restatement of fiscal year 2006 results in a $12.6 million rate reduction recommendation.

**Q. Which fiscal year result are you recommending to the TRA?**

The fiscal year forecast for 2006 is based on partial historic amounts and partial forecasted amounts and it has been recast to address the known effects of Atmos' consolidation. Atmos itself acknowledges that it is better to "minimize the length of the period being projected and utilize the most current data available."[82] Consequently, the more amounts are known (historical), the better instrument for setting prospective rates.

Therefore, based on the consistent trend[83] of earnings with minimal attrition, in excess of a just and reasonable rate of return as demonstrated by Dr. Brown, a rate decrease to Atmos is warranted by the TRA for the benefit of Tennessee ratepayers.

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[82]Atmos Direct Testimony, Mr. Waller, Page 3 of 12, lines 12 and 13.

[83]September 2004 is a historical unadjusted rate of return; September 2005's reported rate of return of 10.16% was adjusted to 10.53% by the TRA Staff; September 2006 and September 2007 forecast reflect known and reasonably anticipated adjustments.

Using the recommended 2006 fiscal year forecast, a rate decrease of $12,618,008[84] would be just and reasonable.

**Q. Please summarize your testimony.**

A. While there is markedly different results between the forecasts of Atmos and the CAPD, the CAPD's forecast was calculated with supporting documentation and based on the financial records and discovery responses of Atmos. In contrast, Atmos' forecast lacks detailed calculations and in some instances contradicts their own records. Also, all of the synergies gained by the combination of the Divisions are not known.

Atmos is a rate base regulated utility operating in Tennessee. Atmos' ratepayers deserve just and reasonable rates. In light of the record in this docket, the TRA is presented with an opportunity to establish just rates through a significant rate reduction.

Therefore, the CAPD submits and pleads to the TRA for a $12.6 million rate reduction for Tennessee ratepayers.

**Q. Does this conclude your testimony?**

A. Yes, it does.

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[84]CAPD 2006 Exhibit, Schedule 1, Line 8.