

Atmos Energy Corporation (“Atmos”), formerly United Cities Gas Company (“United Cities”) is a natural gas distribution company, organized and existing under the laws of the States of Illinois and Virginia, and operating in certain areas in the State of Tennessee. Since 1970, Atmos’s rates have been subject to a Purchased Gas Adjustment (“PGA”) provision in its rate tariff which permits the Company to track increases or decreases in its purchased gas costs. Atmos’s rates are

also subject to an experimental Weather Normalization Adjustment (“WNA”) which was approved pursuant to the generic proceeding before the Tennessee Public Service Commission (“TPSC” or the “Commission”) in Docket No. 91-01712.

On March 30, 1992, United Cities filed with the TPSC a petition in Docket No. 92-02987 requesting a rate increase of \$2.9 million. The filing included an overall rate of return of 11.03%, with a 12.6% return on equity. Prior to the hearing on September 2, 1992, the TPSC Staff and the Company reached a settlement agreement, which was brought before the TPSC for consideration. The TPSC reviewed the evidence and approved the settlement agreement in total at the hearing. The agreement called for a \$1.7 million rate increase and incorporated the overall return and return on equity included in the Company’s original filing.¹

On May 15, 1995, United Cities filed with the TPSC a petition in Docket No. 95-02258 requesting a rate increase of \$3.9 million. At the hearing on October 11, 1995, the parties announced a settlement which provided an agreed-upon revenue deficiency of \$2.2 million. The TPSC, upon consideration of all evidence, found the settlement as to revenue deficiency to be reasonable and approved the same.²

On January 20, 1995, United Cities filed an application with the TPSC proposing that instead of reviewing United Cities’ performance after-the-fact by way of a prudence review,³ as had been traditionally done, the TPSC review United Cities’ performance on an ongoing basis. United Cities requested that it be authorized to conduct a two-year experiment whereby the TPSC would determine whether the Company was performing reasonably in managing and acquiring its gas supply by measuring United Cities’ performance against pre-defined benchmarks that would act as surrogates

¹ See *In re: Petition of United Cities Gas Company to Place Into Effect Revised Tariff Sheets*, Docket No. 92-02987, Order (September 21, 1992).

² See *In re: Petition of United Cities Gas to Place Into Effect Revised Tariff Sheets*, Docket No. 95-02258, Order (November 20, 1995).

³ Under the Purchased Gas Adjustment (PGA) Rules (TRA Rule Section 1220-4-7-.05) an audit of the prudence of gas purchases applies to any gas company with operating revenues of \$2,500,000 or more. The Rule states that a qualified consultant, hired by the TRA, is to evaluate and report annually to the TRA on the prudence of all gas costs which were incurred by the gas company during the previous year.

for the market price of gas. The proposal was premised on United Cities' contention that under a performance-based proposal, the Company would become more accountable to customers for its management and acquisition of gas supplies.

The TPSC convened a hearing at which evidence was presented by United Cities and the Consumer Advocate. The TPSC issued an order on May 12, 1995 approving the proposal with certain modifications including a Gas Procurement Mechanism whereby United Cities would share equally with its customers all gas costs savings below 98% of the market and would also bear a share of the costs in excess of 102% of the market.

On February 2, 1996, an independent consultant filed the first report with the TPSC, recommending certain modifications to the performance-based ratemaking ("PBR") mechanism for the second year. After the consultant's report was filed, the TPSC conducted a hearing on the matter on March 5, 1996. On May 3, 1996, the TPSC issued an order modifying the PBR mechanism in accordance with the consultant's report. The Consumer Advocate appealed the TPSC's order.

On March 5, 1997, the Tennessee Court of Appeals issued an Order vacating the TPSC's Order of May 3, 1996. Because the TPSC was dissolved by act of the Tennessee General Assembly on June 30, 1996, the Court of Appeals remanded the case to the TRA for further proceedings.⁴

On May 20, 1997, the Authority convened a contested case in TRA Docket No. 97-01364. The Authority bifurcated the case to consider the issues arising from the remand by the Court of Appeals (Phase One) separate from the issues arising from United Cities' petition seeking approval of a permanent performance-based rate making mechanism (Phase Two). The Phase One and Phase Two hearings took place on March 26, 27 and 31, 1998.

The Authority issued its Final Order on Phase One and its Final Order on Phase Two on January 14, 1999, and April 16, 1999, respectively. The determinations of the Authority in the Phase

⁴ *Tennessee Consumer Advocate v. Tennessee Regulatory Authority and United Cities Gas Company*, No. 01A01-9606-BC-00286, 1997 WL 92079, at *4 (Tenn.Ct.App. March 5, 1997).

One order included adjusting the lower end of the deadband around the benchmark price to 97.7% for the second year of the plan. The Authority did not adjust the high end level of deadband which remained at 102%. The determinations in the Phase Two order included approving United Cities' PBR plan to be a permanent plan effective April 1, 1999 and increasing the earnings cap per year on overall gains and losses from \$300,000 to \$1.25 million annually beginning April 1, 1999. The rationale provided for this increase was to provide the Company with the necessary incentives to continue to become more aggressive by assuming additional risk in the purchasing of natural gas and in managing its firm transportation capacity on the upstream pipelines.⁵

Consumer Advocate's Petition in Docket No. 04-00356

On October 15, 2004, Consumer Advocate filed a *Petition to Require Atmos Energy Corporation to Appear and Show Cause that Its Rates are Just and Reasonable and that It is Not Overearning in Violation of Tennessee Law*. In that petition, the Consumer Advocate alleged that Atmos' current rate of return in Tennessee exceeds what the TRA has recently determined to be a fair rate of return in certain rate cases. The Consumer Advocate requested that the Authority initiate a show cause proceeding against Atmos and issue a show cause order requiring Atmos to demonstrate to the TRA why its rates should not be reduced. The petition was assigned Docket No. 04-00356. Atmos responded to the petition on November 16, 2004, refuting the authority of the Consumer Advocate to require a show cause action and denying that its rate of return is unfair.

The voting panel assigned to the Docket No. 04-00356, Directors Deborah Taylor Tate, Sara Kyle and Ron Jones, considered the petition at the March 14, 2005 Authority Conference, at which time a majority of the panel voted to deny the petition.⁶ The majority also determined that the Consumer Advocate could bring its allegations back before the Authority by filing a specific complaint against Atmos.

⁵ *In Re: Application of United Cities Gas Company to Establish an Experimental Performance-Based Ratemaking Mechanism*, Docket No. 97-01364, *Final Order on Phase Two*, p. 23 (August 16, 1999).

⁶ Director Jones did not vote with the majority but instead moved to convene a contested case based on the allegations in the Consumer Advocate's petition in Docket No. 04-00356.

CURRENT DOCKET NO. 05-00258

Consumer Advocate's *Petition*

On September 15, 2005, the Consumer Advocate filed the *Petition*, asserting that Atmos is overcharging its customers in Tennessee by at least \$10 million and asking the Authority to open an investigation to determine whether Atmos is overearning by charging rates that are not just and reasonable. In its *Petition*, the Consumer Advocate states that it has conducted a review of rates charged by Atmos and that, based on several factors, it has determined that those rates are excessive, in violation of Tennessee law and do not meet the just and reasonable standard. The *Petition* alleges that Atmos was earning a rate of return of 11.02% on its investments in Tennessee during the twelve-month period ending September 30, 2004, a rate of return in Tennessee that is not fair based on rates of return recently determined by the TRA in other dockets.⁷ According to the *Petition*, revising Atmos's tariffs to incorporate a fair rate of return would lower Atmos's prices for natural gas service for consumers in Bedford County, Blount County, Carter County, Greene County, Hamblin County, Hancock County, Hawkins County, Johnson County, Maury County, Moore County, Obion County, Rutherford County, Sullivan County, Washington County, and Williamson County.⁸ In support of these allegations, the Consumer Advocate filed the Direct Testimony of Steve Brown, Ph.D. and Daniel W. McCormac, CPA, together with exhibits. The Consumer Advocate asks the TRA to conduct an investigation and proceed with a show cause action.

The Consumer Advocate distinguished this *Petition* from the petition filed in Docket No. 04-00356, asserting that this *Petition* sets out the procedure the Consumer Advocate requests of the TRA. In addition, the Consumer Advocate asserts that the new *Petition* puts forth "proof" not contained in the earlier petition that demonstrates that Atmos is overearning and asks the TRA to initially conduct an investigation based on the allegations and supporting proof in the *Petition*.

⁷ *Consumer Advocate's Petition to Open an Investigation to Determine Whether Atmos Energy Corporation Should be Required by the TRA to Appear and Show Cause that Atmos Energy Corporation is Not Overearning in Violation of Tennessee Law and that It is Charging Rates that are Just and Reasonable*, pp. 7-9 (October 15, 2004) ("*Petition*").

⁸ *Id.* at 8.

Atmos's Response

On October 18, 2005, Atmos filed its response to the *Petition* stating that the Consumer Advocate “does not allege that Atmos is earning more than the rate of return authorized by the [TRA].”⁹ Atmos argues that the Consumer Advocate, in challenging the reasonableness of the TRA’s rate decisions, must put forth material and substantial evidence to overcome the presumption that the rates approved by the TRA are valid.¹⁰

The *Response* of Atmos addresses the testimony of Dr. Brown and Dan McCormac, refuting specific allegations and facts in their testimony and includes the testimony of Donald A. Murry, Ph.D., an economist/consultant, to rebut the calculations and analysis put forth by Dr. Brown and Mr. McCormac. Atmos argues that, because the Consumer Advocate is the party seeking affirmative relief, it bears the burden of proving that Atmos’s rate of return has been set at an unreasonable level. Atmos further argues that the *Petition* is an “unprecedented and extraordinary request” supported by “conclusions based on incorrect information and gross mischaracterizations.”¹¹ For these reasons, Atmos asserts that the *Petition* fails “to produce the convincing evidence of a substantial and material nature that is required to overcome the presumption that the rates the TRA set for Atmos are just and reasonable.”¹²

On October 28, 2005, the Consumer Advocate filed a letter in this docket informing the Authority that it would not seek to file a reply to Atmos’ response so that the Authority could consider the *Petition* at the earliest possible date. On November 2, 2005, a group of customers who purchase natural gas from Atmos submitted a letter in support of the Consumer Advocate’s petition and argued that there is sufficient evidence to justify the issuance of a show cause without further

⁹ *Atmos Energy Corporation's Response to the Consumer Advocate's Petition*, p. 1 (October 18, 2005) (“*Response*”).

¹⁰ *Id.* at 5.

¹¹ *Id.* at 13.

¹² *Id.*

investigation.¹³ On November 3, 2005, Chattanooga Gas Company filed a petition to intervene, requesting intervention if the panel grants the request for a show cause hearing.¹⁴

DISCUSSION

The creation of the Consumer Advocate Division and the powers attendant to that division are found in Tenn. Code Ann. § 65-4-118 (2004). Tenn. Code Ann. § 65-4-118(b)(1) provides that the Consumer Advocate may initiate a proceeding before the TRA in accordance with the Uniform Administrative Procedures Act (Tenn. Code Ann. §4-5-101 *et seq.*) and the rules of the TRA. The Consumer Advocate's *Petition* requests the TRA to initiate an investigation and issue a show cause order as a result of that investigation. The request of the Consumer Advocate does not exceed the authority of the Consumer Advocate.

The Consumer Advocate filed sworn testimony together with exhibits in support of its assertion that the rate of return established by the TPSC for Atmos is no longer reasonable and that Atmos is earning well above a reasonable rate of return at the present time. The gravamen of the Consumer Advocate's *Petition* is that Atmos's overall current earned rate-of-return of 11.02% is not just and reasonable based upon current market conditions and recent decisions by the TRA setting rates for other utilities. Dr. Steve Brown concludes in his testimony in support of the *Petition* that the 14.2% equity return that Atmos earned for the year-ending September 2004 far exceeds the normal profit level in all American stock markets and in relation to Tennessee businesses.¹⁵ Dr. Brown also states that Atmos's current level of earnings, overall and equity, are not in line with the TRA's most recent decisions regarding other regulated companies.¹⁶

Daniel McCormac points out in his testimony that the TRA set a return on equity of 10.2% and overall rate-of-return of 7.43% for Chattanooga Gas Company in TRA Docket No. 04-00034, an overall rate-of-return of 8.42% for Nashville Gas Company in TRA Docket No. 03-00313, and

¹³ Letter from Henry Walker, Esq. to Chairman Ron Jones (November 2, 2005).

¹⁴ *Petition to Intervene* filed by Chattanooga Gas Company (November 3, 2005).

¹⁵ Dr. Steve Brown, Pre-Filed Direct Testimony, pp. 4-6 (September 14, 2005).

¹⁶ *Id.* at 7.

during the last rate case for Tennessee American Water (TRA Docket No. 04-00288), the Authority set an overall rate-of-return of 7.76% with an equity return of 9.9%.¹⁷ Mr. McCormac calculates that Atmos is overearning \$10.2 million on the equity component alone and states that this level of overearnings results in consumers being overcharged by 6%.¹⁸

The Consumer Advocate alleges other factors relating to the rate-of-return in support of its request for an investigation. According to the Consumer Advocate, when Atmos purchased United Cities, the revenue streams, capital structure and cost of debt changed from that used as a base in determining the current authorized rate-of-return. In addition, the Consumer Advocate asserts that employee levels were reduced and efficiencies gained when the acquisition was complete.¹⁹ Likewise, the Consumer Advocate contends that Atmos's recent acquisition of TXU provides the ability to reduce expenses, including employee levels, through consolidated operations.²⁰

The Consumer Advocate also points out that Atmos has been through two major mergers or acquisitions since the rate-of-return was last set in 1995 and that all customer service, accounting and management functions have been relocated to Texas. The Consumer Advocate states that there has been no determination whether allocation of these costs to Tennessee operations is accurate.²¹

The principal response of Atmos to the Consumer Advocate's *Petition* is that the Consumer Advocate has not met a stiff burden of proof to justify the granting of the *Petition*. Atmos provides a detailed argument addressing the burden and type of proof required to rebut the presumption of validity afforded the TRA's decisions in setting rates. The burden of proof would be on the Consumer Advocate in filing a complaint case. The arguments of Atmos go to the proof put forth by a party in the record after a hearing, not to whether a complaint sufficiently alleges a cause of action upon which relief may be granted. Only after full development of the record in a contested case,

¹⁷ Daniel W. McCormac Pre-Filed Testimony, p. 7 (September 14, 2005).

¹⁸ *Id.* at 1-2.

¹⁹ *Id.* at 3-6.

²⁰ *Id.* at 5.

²¹ *Id.* at 6.

would the Authority consider the issue of whether one party or another met is requisite burden of proving its case. Nevertheless, there is no specific burden of proof that must be met by the Consumer Advocate or any person requesting the TRA to initiate an investigation. For the purpose of considering whether or not to commence an investigation, the *Petition* provides ample information to the TRA.

The major mergers and acquisitions undergone by Atmos may have changed expenses through consolidated operations and therefore would justify investigation to determine the appropriate amounts to include in establishing just and reasonable rates. Costs and expenses may have changed due to moving certain operations, such as customer service, accounting and management functions, to Texas and such changes should be recognized in establishing rates.

NOVEMBER 7, 2005 AUTHORITY CONFERENCE


The panel considered the *Petition* of the Consumer Advocate at an Authority Conference held on November 7, 2005. The panel acknowledged that there is no express statute or case law establishing a standard to apply when determining whether to grant or deny a request to initiate an investigation. Rather, such a decision is a discretionary determination, and in exercising that discretion the panel should weigh several factors. The harm that might result from not taking action in the event the allegations in the *Petition* are in fact true must be considered along with the ability of the petitioner to substantiate its claim without Authority intervention and the harm that may result to the entity that is the subject of the inquiry.

Based on a review of the *Petition* together with supporting documentation, and the *Response* of Atmos, the Directors voted unanimously to grant the *Petition* of the Consumer Advocate as to conducting an investigation to determine whether sufficient facts exist for the issuance of a show cause order. In voting to open an investigation, the panel did not make any determination regarding whether to proceed with a show cause proceeding. Such a determination would be based on the results of the investigation relating to allegations set forth in the Consumer Advocate's *Petition*,

amongst other things. Further, the panel determined that the names of investigative staff shall be published in the record of this docket. Investigative staff shall, upon completion of the investigation, prepare and file a report containing a recommendation for consideration by this panel. Further, the panel voted unanimously to defer consideration of Chattanooga Gas Company's petition to intervene until after the filing of the investigators' report.

IT IS THEREFORE ORDERED THAT:

1. The *Consumer Advocate's Petition to Open an Investigation to Determine Whether Atmos Energy Corporation Should be Required by the TRA to Appear and Show Cause that Atmos Energy Corporation is Not Overearning in Violation of Tennessee Law and that It is Charging Rates that are Just and Reasonable* is granted.
2. The investigative staff shall publish the names of the investigators in the record.
3. Upon completion of the investigation, the investigative staff shall file a report containing a recommendation for consideration by the panel.
4. Consideration of Chattanooga Gas Company's petition to intervene is deferred until after the filing of the investigators' report.



Ron Jones, Chairman

Deborah Taylor Tate, Director²²



Pat Miller, Director

²² Director Tate voted in agreement with the other directors but resigned her position as director before the issuance of this order.