TENNESSEE REGULATORY AUTHORITY

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460 James Robertson Parkway
Nashville, Tennessee 37243-0505

October 25, 2006

Chairman Sara Kyle
Tennessee Regulatory Authority
460 James Robertson Pkwy.
Nashville, TN 37243

RE: ***Petition to Open An Investigation to Determine Whether Atmos Energy Corp. Should Be Required by The Tennessee Regulatory Authority to Appear And Show Cause That Atmos Energy Corp. Is Not Overearning In Violation of Tennessee Law And That It Is Charging Rates That Are Just And Reasonable, TRA Docket No. 05-000258***

Dear Chairman Kyle:

Please find the attached motion that I plan to make in our scheduled hearing tomorrow in the above referenced docket. For your convenience, I am filing this today in order that you have sufficient time to review before we deliberate tomorrow.

In kindest regards, I am

Yours truly,

Pat Miller

Pat Miller

Smb
Attachment
cc: Docket File 05-00258

Director Miller's Motion
Docket 05-00258

Base/Test Year

Based on case law and arguments brought forth by both Atmos and the Consumer Advocate, it is clear that the Authority is not compelled to use a forecast test period in order to account for attrition. In setting rates the Authority may use a historical test period, a forecast period, or a combination of the two as long as the rates account for known changes likely to occur in the immediate future. While I am of the opinion that the Authority is not obligated to use a forecast period to predict attrition or rates, I have determined that, in this docket, using a forecast period of the twelve months ending September 30, 2007, is the best method for examining and setting rates.

Burden of Proof

In this docket, the burden of proof is upon the Consumer Advocate, Investigative Staff, and any Intervenors bringing forth issues and asserting the affirmative of the claim that Atmos is overearning in violation of Tennessee law and/or not charging rates that are just and reasonable. There has not been an improper *de facto* shifting of the burden of proof to Atmos. Nevertheless, on the issues that Atmos brings forth and on its request that its rates be increased because it is under earning or operating at a deficit to what is permitted by law, the burden of proof rests fittingly upon Atmos.

Revenue/Margins

The record demonstrates that the margin trend used by Consumer Advocate and Protection Division (I will refer to as "CAPD" hereafter) is highly dependent on the time period examined and varies greatly on timing factors. For these reasons, CAPD's margin trend cannot be relied upon and should not be used in this case.

CAPD's argument regarding the lack of support for Atmos' price-out does, however, have limited merit. Due to Atmos' rate structure's dependence on volumetric rates to recover a portion of its revenue requirements, price-out results are highly dependent on usage levels which, based on the record, do not appear to follow a strong trend for all classes of service. There is, however, an evident trend in residential customer growth which exceeds that used by Atmos in its price-out. Additionally, the Company made a lump sum adjustment to margins for forecasted Service/Late Charges, which decreased by 15% with no justification.

For these reasons, I move to reject CAPD's margin forecast of $55,485,148, and adopt Atmos' price-out with the following modifications:

1. Reject Atmos' forecast of Service/Late Charges and use, instead, the actual amount of $2,037,384 included in the Company's price-out schedule;
2. Reject the Company's residential revenue forecast;

3. Grow the number of residential bills for the twelve months ended March 2006 for 18 months, using 2.4% growth in the summer months and 2.5% growth in the winter months, to arrive at the number of bills for the twelve months ended September 30, 2007;
4. Per the methodology reflected in the Company's price-out schedule, grow residential volumetric usage for the 12 months ended March 2006 by the same percentages as number of bills and apply the 1.5% declining usage factor; and
5. Include the residential WNA revenue as a lump sum addition.

My motion results in a gross margin forecast of $52,867,802 for the twelve months ending September 30, 2007.

Operation and Maintenance Expense

Consistent with the methodology to forecast revenues, a price out for labor should be utilized. The submission of CAPD is based upon a full year of verifiable data using existing employee levels as of 2005. Additionally, the company has confirmed that employee levels have remained relatively constant. Further, the evidence in this case supports adoption of the sixty percent (60%) capitalization rate proposed by CAPD.

The evidence presented further demonstrates that the Long Term Incentive Plan ("LTIP") is a bonus plan, strictly for Atmos employees, and based exclusively on earnings. Atmos provided no justification countering this assertion other than LTIP is part of a market compensation package. Further, LTIP provides no benefit to ratepayers.

Atmos does not argue that the minimum required contribution for pension is zero ($0.00), but asserts that a typical amount should be included as expense. Based upon the evidence presented in this case, I see no justification for the Authority to alter its previous finding to fund only actual pension contributions.

As regarding expense for Environmental Clean Up Costs, it is clear from the TPSC's Order in Docket 94-02529 that Atmos may defer the costs associated with "state and federally mandated environment control requirements." It is also evident from that Order that before any amount associated with this deferral is expensed, there is to be a hearing to determine the authenticity of such costs and the manner of recovery.

The evidence does not demonstrate that CAPD's estimate of uncollectibles is understated because of a ninety (90) day lag and high gas costs.

The parties have agreed to a rate case cost of $165,000 presented in this docket. The period of recovery, however, is at issue. I believe a prudent and reasonable time period for recovery of this cost is three (3) years.

For these reasons, I move adopting the Operation and Maintenance expense amount from Atmos' trial balance for the twelve (12) months ended March 31, 2006 with the following adjustments to forecast the expense amount for the twelve months ending September 30, 3007:

1. adjust the direct labor expense and capitalization to that submitted by CAPD;
2. deny inclusion of LTIP expense and include a minimum pension contribution of $0.00 for the twelve months ending September 30, 2007.
3. adjust the uncollectible amount to $95,759 as presented by CAPD;
4. deny inclusion of Environmental Clean Up amounts. Atmos may, however, bring this issue before the Authority in the future for a hearing to determine the appropriate amount to be recovered and the manner of recovery;
5. adopt a three year recovery period for the rate case expense; and
6. apply an eighteen (18) month growth factor of 1.85% and inflation factor of 4.4% to the remaining accounts.

These adjustments to Atmos' O&M expense amount for the twelve months ended March 31, 2006 will result in an Operation and Maintenance expense of $13, 869,302 for the twelve months ending September 30, 2007.

Depreciation

Atmos' recommended depreciation expense includes the projection of depreciation for the shared services unit based upon a study performed in 2002, while CAPD's forecasted depreciation was based upon September 30, 2005 actual amounts. The study relied upon by Atmos only covers a portion of Tennessee assets and is over four (4) years old. For these reasons, I move adopting the depreciation expense amount of $11,706,765 as presented by CAPD for the twelve months ending September 30, 2007.

Taxes Other Than Income

Atmos asserts that the difference in other taxes between the company and CAPD is due to the CAPD's failure to include the shared service tax and Department of Transportation ("DOT") taxes and basing the 2007 gross receipts tax expense on gas costs of 2005. The financial records of Atmos verify that shared service and DOT taxes are incurred and CAPD has provided no evidence to the contrary. Therefore, I move adopting $179,372 shared service and DOT tax for the twelve (12) months ending September 30, 2007, as presented by Atmos in Discovery Response Item 2-11.

Although gas prices during last winter were high due to damage caused by hurricanes, they have since declined dramatically. Atmos provided no evidence to support that the gas prices of today, which are comparable to 2005, would increase to levels of last winter, for the forecasted period ending September 30, 2007. Nor did CAPD present evidence to support that the gas prices of today would remain constant throughout the forecasted period. I move that the Gross Receipts Tax be calculated using an average of the twelve months to date March 2005 and March 2006 gas cost. Using this average tempers the effect of the hurricanes on gas prices during the 2005/2006 heating season, while recognizing that the cost of gas will, as normal, increase to some extent during the winter.

The CAPD's corrected Payroll tax is computed based upon the labor price out submitted. Based upon the correction made by CAPD during the hearing the projection of CAPD is no longer a matter of contention between the parties. Therefore, I move to adopt the payroll tax submitted by CAPD for the twelve (12) months ending September 30, 2007.

The TRA Inspection Fee should be calculated based upon revenues. I therefore move the inspection fee be based upon the revenues for the forecasted period using the approved 0.20% rate.

Based upon verification of the amounts for property and franchise tax submitted by CAPD and the lack of support for the amounts presented by Atmos, I move for the adoption of CAPD's proposed Property Tax and Franchise Tax for the twelve (12) months ending September 30, 2007.

My motion results in Taxes Other Than Income in the amount of $5,520,000.

State Excise and Federal Income Tax

The Tennessee Excise Tax and the Federal Income Tax are 6.5% and 35% income taxes on earnings of the Company. Based on my previous motions, I move to adopt combined income taxes totaling $6,927,407.

Net Operating Income (NOI) Adjustments

I move the Authority approve Net Operating Income adjustments totaling $1,708, 667. This amount includes increases for Gain on Sale of Maryland Way Property and Net Elimination of Lease Property as agreed to by the parties. Additionally, the parties agree upon the appropriate factor to apply in calculating interest on customer's deposits. Furthermore, six percent (6%) is the approved tariff rate. Therefore, six percent (6%) should be applied to rate base customer deposits, resulting in $388,258 Interest on Customer Deposits for the twelve months ending September 30, 2007. Finally, Allowance for Funds Used During Construction ("AFUDC") is a component of construction costs representing net cost of borrowed funds and a reasonable rate on other funds used during the period of construction, and CAPD properly includes Allowance for Funds Used During Construction as an adjustment to Net Operating Income. Therefore, CAPD's Allowance for Funds Used During Construction amount of $235,383 should be adopted.

Rate Base

I move the Authority adopt a Rate Base comprised of Gas Plant in Service, Construction Work in Progress, Inventories of Materials and Supplies/Storage Gas, Prepayments, Rate Case Expense, Net Elimination of Intercompany Leased Property, Unamortized Maryland Way Gain, Accumulated Depreciation, Customer Deposits, Contributions and Advances in Aid of Construction, and Accumulated Deferred FIT.

Rate base amounts are based on 13 month averages of each account. The allocation factors for Service Areas 88, 90, 91, and 10 changed on October 1, 2006. CAPD made a normalizing adjustment to the September 2006 allocation factors representing this known change in the 13 month average. In response to my question during the hearing, Atmos concurred with this adjustment. I, therefore, move the normalizing adjustment to the September 2006 allocation percentages, as proposed by the Consumer Advocate, be accepted for each account.

Further, I move to adopt the amounts proposed by Atmos in the First Joint Discovery Data Responses #33 and #36, after the normalizing adjustment to September 2006 allocation percentages, with the following exceptions:

1. adopt the Consumer Advocate's methodology for calculating net additions to Gas Plant in Service from June 2006 through September 2007 but reject adjustments made in the months prior to June 2006. Both the Consumer Advocate and Atmos added the same amount to Gas Plant in Service which discounts the Company's argument regarding "disappearing" Construction Work in Progress. I further find that the primary cause of the difference between the parties on this issue results from Atmos' failure to carry through the Gas Plant in Service additions for June through September from the corrected gross plant additions exhibit included in the Peterson and Waller Rebuttal Testimony. Consistent with the exclusion of LTIP expense, capitalized LTIP is excluded from Gas Plant in Service.
2. adopt the Consumer Advocate's methodology for calculating Accumulated Depreciation additions from June 2006 through September 2007, but reject adjustments made in months prior to June 2006, which again represent the primary difference between the amounts proposed by the parties. After careful review of the record, I find that the amounts used by Atmos through May 2006 agree with the Company's trial balances. Consistent with the exclusion of LTIP from Gas Plant in Service, also exclude depreciation associated with capitalized LTIP.

3. The CAPD's forecast fails to recognize the seasonality of Customer Deposit amounts, and the Company's forecast for June 2006 through September 2006 suffered from a similar problem by holding deposit amounts constant for those four months. For this reason, I move that the panel adopt the Company's methodology for forecasting FY07 Customer Deposits and apply that same methodology to forecast the final four months of FY06.
4. Further, adopt a hybrid of the amounts proposed by Atmos and CAPD for Accumulated FIT. As with Accumulated Depreciation, CAPD argued that historical amounts relied on by Atmos did not match booked amounts. After careful review of the record, I could not verify the historical amounts used by CAPD but did reconcile the amounts relied on by Atmos to the Company's trial balance. CAPD's changes to Service areas 88, 90, 91, and 10 focused on historical amounts rather than the Company's forecasted changes. After verifying the historical data used by Atmos for these service areas, I find that the company's proposal for Service areas 91 and 10 should be adopted with minor adjustments. The record demonstrates that for service areas 88 and 90, Atmos books Accumulated Deferred FIT amounts in September only, rather than monthly. For this reason, the company's proposal for Service areas 88 and 90 should be adopted with minor changes. For Service Area 93, I move the Authority adopt the methodology proposed by the Consumer Advocate of using the Company's estimated temporary tax difference for 2006 and 2007 at the federal tax rate of 35% as the annual change in this

account. As with service areas 88 and 90, this change should be made in September 2006 and 2007 rather than allocated monthly.

5. Consistent with my motion to adopt a three year recovery period for rate case expense, I move that a Rate Case Expense of $110,000 be included based on a total cost of $165,000;
6. Also, consistent with my motion to reject Atmos' proposed depreciation study, I move to reject the line item proposed by the Company to reflect the impact of that study.

This motion results in a Rate Base totaling $161,330,325.

Capital Structure and Rate of Return

I move the Authority adopt a capital structure consisting of 3.59% short-term debt, 53.03% long-term debt, and 43.38% equity based on the capital structure of Atmos' parent company. I further find that the TRA Investigative Staff's methodology for estimating long-term debt and equity percentages is the most reasonable and best supported by the record in these proceedings; however, the argument against inclusion of short term debt is unpersuasive, especially given that Atmos has short term debt each month for the most recent twelve months in the record and each month prior to the summer of 2004. It is clear, however, that Atmos' use of short term debt is seasonal, and the 3.59% excludes increased short-term debt usage in the heating season.

With respect to debt cost, I move the Authority adopt a short-term debt cost of 5.84%, based on the credit facilities Atmos reported using in its June 30, 2006 10Q, and a long-term debt cost of 6.03%, also as proposed by Atmos.

There is no single correct answer for return on equity. Both Atmos and TRA Investigative Staff perform similar DCF analyses and produce similar ranges based on their analysis. The CAPM analysis performed by Investigative Staff conforms to both standard applications of the model and previous Authority rulings. I further agree with Investigative Staff and Atmos that the DCF dividend growth results, which form the low end of the results range, must be discounted, especially given that the results presented by Atmos for that analysis are lower than the cost of long-term debt. I also agree with Investigative Staff that, in this case, the CAPM results fall at a loose midpoint of the DCF analysis range.

Even with the source for each of the inputs to the CAPM determined, interest rates are a continually moving target. After reviewing the interest rate history of twenty year government bonds submitted by Investigative Staff and their effect on the CAPM results, as well as the history of recent decisions of other state commissions, submitted by Atmos, I move the Authority adopt a return on equity of 10.48% and an overall rate of return of 7.96%.

<u>Other Issues</u>

1) Based upon the record, I move that Atmos should replace 45,000 feet of bare steel per year for the next ten (10) years.

2) Based upon Atmos' ability to replace bare steel in previous years without the use of a tracker, I move to deny the proposed bare steel tracker. I would like to inform the Company that it may petition the Authority for rate relief should future earnings be insufficient to provide a reasonable return.

3) Based upon agreement of the parties, I move that Atmos obtain Authority approval prior to billing for services from third parties.

4) Based upon ambiguity, lack of supporting documentation and scope of this proceeding, I move to deny the service metrics requested by the CAPD.

<u>Rate Restructure/Tariff Change Proposals</u>

1. The evidence presented in this case clearly demonstrates that the proposed rate and class structure of AIG may not be representative of the named interveners in this case and is not representative of all commercial and industrial customers. It does not, in all cases, mirror the rate structure of other gas companies and is not based on a class cost of service study. Further, the individual customer impact upon implementation of the proposed rate restructure cannot be determined from the evidence in this case. I, therefore, move the rate structure proposed by AIG be denied.

2. While raising questions as to the competitive neutrality of existing tariffs, there was very little evidence submitted to ensure that the proposed rate restructures and tariff changes proposed by Atmos regarding definitions, transportation tariff, and main and service line extensions are in the public interest. This proceeding has moved forward on an expedited schedule with its focus being on reviewing Atmos' earnings and establishing just and reasonable rates on a going forward basis based on these earnings. Given the constraints of this proceeding, it is understandable that parties did not have sufficient time to address these additional issues. Therefore, I move the current proposals of Atmos regarding definitions, transportation tariff, and main and service line extensions be denied, however, I encourage Atmos to bring tariff changes and rate restructures before the Authority for consideration, outside of this current proceeding, where those issues may be properly evaluated by all interested parties.

3. The modification proposed by Atmos to include the Customer Utilization Adjustment, also know as CUA, within the Weather Normalization Audit ("WNA") is a novel approach to lessen inaccuracies that may occur when forecasting revenues/margins for Atmos. It is abundantly clear that the recovery of fixed costs through a volumetric charge can lead to over or under recovery of such costs. The proposed CUA, however, does not correct this problem; rather it removes any incentive for Atmos to control fixed costs. Therefore, I move to deny the Customer Utilization Adjustment.

4. The current rate structure includes a fixed monthly customer charge and a volumetric charge. The volumetric charge recovers all gas costs and the fixed costs that are not covered by the monthly customer charge. It is a sound economic and accounting practice to recover a cost in a manner that is similar to that in which it is incurred. It is clear that CAPD recognizes expenses are primarily fixed and dependent on the number of customers, rather than gas volumes. This is demonstrated in the proposal of CAPD to forecast expenses based upon customer growth rather than changes in volume. Therefore, CAPD's contention that increasing the fixed charge discourages conservation is unsubstantiated by the record in this docket. To the contrary, one can assert that removing recovery of fixed costs from a volumetric charge places more control of the total gas bill with the customer. Further, consideration should be given to low income customers when considering this structure. During the high gas cost last winter the Authority was concerned with low income customers that may be living in homes needing insulation or high efficiency appliances, yet unable to afford to make these efficiency improvements. Including a fixed amount in the volumetric charge penalizes these low income consumers because the higher volume results in the customer paying a larger portion of fixed cost. I therefore move to:

   - approve the revenue neutral rate change, within customer class, increasing the customer charge for rate schedules 210 and 211 (Residential, Residential & Small Commercial/Industrial Heating &

Cooling) from $6.00 to $12.00 per month during the winter (November – April) and from $6.00 to $9.00 per month during the summer period (May – September), and

- approve for rate schedule 220 (Commercial/Industrial Gas Service) an increase in the monthly charge from $12.00 per month to $24.00.

I further move:

- these rate changes include Atmos' commitment to waive the monthly customer charge for residential customers 65 or older who meet the low income threshold.
- Atmos should make this rate change based on twelve (12) month volumes as of September 30, 2006, and 1) the revenue generated from increasing the 210 Residential monthly customer charge should be used first to reduce the winter fixed volumetric rate to $.2257. Then, the remaining revenue should be used for further reduction of the overall $.2257 volumetric rate; 2) the revenue generated from increasing the 211 Residential and Small Commercial/Industrial Heating and Cooling should be used to reduce the fixed volumetric rate for that class; and, 3) the revenue generated from increasing the 220 Commercial/Industrial Gas Service from $12.00 per month to $24.00 should be offset with a reduction in the volumetric rate for this class. Atmos should file revised tariffs with documentation demonstrating the revenue neutrality of this change within thirty (30) days.

5. Finally, I move the panel grant Atmos' proposal to increase the activation charge for rate class 210, and deny the requested increase for rate classes 220, 221, 222, 230, 250, 260, 280, 292 and 293. This activation charge will apply to all meter turn-ons at existing locations and all reconnects, and this charge will not apply when a transfer of service is requested and only a meter read is required as opposed to reconnection.

Revenue Requirement/Rate Design

Based on my previous motions I calculate a Net Operating Income surplus of $3,711,101. Due to the effect of taxes, uncollectibles and forfeited discounts, a revenue conversion factor must be applied to the Net Operating Income surplus in order to translate it into a revenue surplus for rate design purposes.

I move to adopt CAPD's methodology for calculating the revenue conversion factor, as well as the forfeited discounts ratio. The forfeited discounts ratio is the actual percentage for the 12 months ended March 31, 2006[1] and appears to be a reasonable reflection of historical ratios.[2] The uncollectible ratio was calculated using the recommended amounts for uncollectibles and gross margin. Using these ratios and the prevailing federal income and state excise tax rates, results in a revenue conversion factor of 1.636128.

[1] Dan McCormac, Pre-filed Direct Testimony, p. 2 (July 17, 2006).
[2] Dan McCormac, Pre-filed Direct Testimony, Exhibit DM-7 (July 17, 2006).

Applying this 1.636128 revenue conversion factor, I find that Atmos has $6,071,837 revenue surplus for the twelve (12) months ending September 30, 2007. To ensure that all customers realize a portion of this surplus, I further move that the surplus be utilized by reducing the volumetric rate for each class of service based upon the revenue of each class. Atmos should file tariffs for this reduction within thirty (30) days. Finally, the price out demonstrating a reduction for the revenue surplus should be provided subsequent to the price out pertaining to the revenue neutral changes of my previous motion.