

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

IN RE: PETITION TO OPEN AN)
INVESTIGATION TO DETERMINE)
WHETHER ATMOS ENERGY CORP.)
SHOULD BE REQUIRED BY THE TRA)
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)

Docket No. 05-00258

Atmos Energy Corporation's Response to Director Miller's Motion for Reconsideration

Atmos Energy Corporation ("Atmos" or the "Company") files this Response to the Motion for Reconsideration submitted by Director Miller on March 23, 2006.

I. INTRODUCTION.

At the March 20, 2006 agenda conference, Director Miller stated that, in light of the unwarranted public statements by the Consumer Advocate and Protection Division ("CAPD") and others accusing the TRA of foot-dragging in this case, he intended, by his Motion to Reconsider, to ask the parties to come forward to state their positions on what they believe is the most expeditious approach that should be taken in this docket. Atmos makes this filing in response to Director Miller's request for input from the parties.

Two options for proceeding in this docket have been presented thus far: (1) convening a contested case; and (2) proceeding with the TRA Staff investigation. Director Miller, Director Kyle, and Chairman Jones have all suggested that perhaps the TRA should terminate the TRA Staff investigation and convene a contested case so that the CAPD could be required to bear the burden of proof as to the allegations it has made that Atmos' authorized rate of return is too high.

The CAPD, on the other hand, has remained firm in its steadfast refusal to accept the burden of proving its allegations, and has stated instead that the TRA Staff is the entity that should be charged with the duty to investigate the CAPD's allegations.

Numerous public statements have been made by the CAPD and others characterizing the allegations that have been made and the objectives of this docket, and describing how the docket will proceed. Many of these public statements are wholly inaccurate. In light of the amount of misinformation about this docket, it is important to clarify what the CAPD has alleged, what the TRA has ordered to date, and the procedural and substantive implications resulting from the allegations and existing order. This clarification is necessary in order to determine what effect a revised decision may have on the TRA Staff, the parties and the progress of this docket.

The CAPD has not alleged that Atmos is earning more than it is authorized, but has instead challenged the reasonableness of the rates set by the TRA in Atmos' last rate case. What this means is that the CAPD is asking for a full blown rate case, plain and simple. The CAPD not only concedes a full rate case is what it is requesting, but also acknowledges the extent of resources required for a full rate case is considerable.¹ Regardless of form or nomenclature, if the TRA convenes a case for the purpose of determining the validity of the CAPD's allegations, both Atmos and the TRA will be forced to expend the enormous amount of resources required to litigate, advise, and preside over a full rate case.² As such, this docket will have far reaching policy repercussions for the TRA, the utilities, and the ratepayers: **The TRA's decision in this**

¹ See CAPD Petition, p. 3 (“[n]either the consumers nor the Consumer Advocate should be required to file a complaint and attempt to compile the information necessary to put on a rate case.”); CAPD Resp. in Opposition to Director Miller's Mot. for Reconsideration, p. 3) (“[t]he Consumer Advocate recognizes the complexity of the matter before the TRA....”).

² As the TRA well knows, rate cases are not simple or quick matters, but instead require hundreds of manhours of time to present and consider proof on a wide range of complex and interrelated issues. During the past few years, the average length of time to complete a rate case from start to finish has ranged from 10 to 22 months.

case will determine whether the CAPD can force a utility and the TRA to conduct a full rate case, and if so, what threshold showing the CAPD must make to do so.

II. THE TRA’S ORDER DIRECTING A STAFF INVESTIGATION HAS PLACED AN ONEROUS BURDEN ON TRA STAFF THAT IS NOT JUSTIFIED UNDER THE CIRCUMSTANCES.

The TRA has ordered Staff to conduct an investigation and recommend to the TRA whether sufficient cause exists to issue a show cause order against Atmos.³ The CAPD and others have characterized the Staff’s task as “look[ing] at the information the Consumer Advocate submitted with its Petition and [making] a decision.”⁴ Henry Walker, who contends he represents an as yet unidentified group of Atmos customers, notes in his recent filing that it has been approximately 5 months since the TRA’s order directing the Staff investigation, and declares, inexplicably, that “[t]he staff’s investigation should be complete, or nearly so.”⁵

The comments by the CAPD and Mr. Walker are inaccurate and misleading. Staff has been directed to: (1) investigate the CAPD’s allegation that Atmos’ authorized rate is too high; and (2) determine whether sufficient cause exists for the issuance of a show cause order. Contrary to the CAPD’s comments, an investigation of the CAPD’s allegations ***does not*** entail merely looking at the material submitted by the CAPD. The only way TRA Staff can determine if Atmos’ authorized rate of return is too high is ***make a finding as to precisely what Atmos’ rate of return should be.***

To do this, Staff must examine the Company financial records and relevant economic data in order to:

³ Order Granting Pet. and Convening Investigation, pp. 9-10.

⁴ CAPD Resp. in Opposition to Director Miller’s Mot., p. 2.

⁵ Comments of Atmos Intervention Group in Resp. to Mot. to Reconsider, p.2.

- (1) determine the appropriate capital structure for the company;
- (2) determine the cost rates for each component of the capital structure (short-term debt, long-term debt, and common equity); and
- (3) compute the overall weighted cost of capital, which represents the fair rate of return.⁶

To compute the company's cost of equity, Staff must conduct an analysis to determine the return investors earn in other enterprises having risk levels which correspond to those of the company. Tennessee-American Water Co., 1985 Tenn. App. Lexis at * 5; AARP v. Tennessee Public Svc. Comm'n, 896 S.W.2d 127, 132 (Tenn. Ct. App. 1994) (cautioning that "the critical inquiry is not the rate of return on equity of *similar* companies but the return on equity in enterprises having *comparable risks*."') (emphasis added).

Staff must also determine the rates which permit Atmos to: (1) meet its costs of service and other expenses and operate successfully; (2) maintain its financial integrity; (3) attract capital; and (4) earn a return on its investment that is equal to that earned on investments in other companies with corresponding risks.⁷

Because the rate of return is so dependent on the financial characteristics of the particular company at issue, Staff is required by Tennessee law to carefully consider Atmos' particular financial condition in setting the Company's rates. Tennessee Cable Television Assoc. v. Tennessee Public Svc. Comm'n, 844 S.W.2d 151, 160 (Tenn. Ct. App. 1992) ("the Commission must consider the adequacy of the company's service when it is fixing rates, and *must consider* the company's financial condition") (emphasis added); Tennessee-American Water Co., 1985

⁶ TRA Docket No. 04-0034, 10/20/04 Order, p. 39 (internal citations omitted.); Tennessee-American Water Co. v. Tennessee Public Svc. Comm'n, 1985 Tenn. App. Lexis 2800 at *4 (Tenn. Ct. App. Apr. 11, 1985).

⁷ 10/20/04 Order in Docket No. 04-0034 at pp. 39-40. (citing Bluefield Water Works v. Public Svc. Comm'n, 262 U.S. 679, 692 (1923)).

Tenn. App. Lexis 2800 at * 5 (“the Commission, in setting the utility’s rate of return, *must analyze* the financial structure of the company to determine its capital requirements, its levels of debt, and the return an equity investor would expect to return.”) (emphasis added). Therefore, Staff cannot merely conduct a comparison of Atmos’ rates with those of other gas companies.

Because Staff has been charged with investigating allegations which challenge the reasonableness of the rates the TRA set for Atmos in its order in the Company’s last rate case, Staff must determine if *convincing evidence of a substantial and material nature* exists as to each of the factors and components outlined above before a recommendation can be made on whether a show cause order be issued. CF Indus. V. Tennessee Pub. Serv. Comm’n, 599 S.W.2d 536, 540 (Tenn. 1980); Southern Bell Telephone & Telegraph Co. v. Tennessee Pub. Serv. Comm’n, 304 S.W.2d 640, 649 (Tenn. 1957).

The show cause statute also requires that Staff make a specific recommendation as to what Atmos’ rates should be before recommending that a show cause order issue. A show cause order may not issue unless the Authority makes a determination that a violation of law has occurred. Williams v. Pittard, 604 S.W.2d 845, 849-50 (Tenn. 1980). In the absence of a specific determination that a violation of law has occurred, the issuance of a show cause order violates the constitutional right to due process. Id. In this case, the alleged violation of law is that Atmos’ authorized rates are not just and reasonable. The only way the Authority can reach a determination that Atmos’ existing rates are not just and reasonable is by determining what would constitute just and reasonable rates. Therefore, it is clear that Staff must make a determination as to what Atmos’ authorized rates should be.

The show cause statute also requires that the show cause order specifically indicate the action the Authority determines is justified:

The authority is empowered and authorized in the exercise of the powers and jurisdiction conferred upon it by law to issue orders on its own ***motion citing persons under its jurisdiction to appear before it and show cause why the authority should not take such action as the authority shall indicate in its show cause order appears justified by preliminary investigation made by the authority under the powers conferred by law.*** All such show cause orders shall fully and specifically state the grounds and bases thereof, and the respondents named in the orders shall be given an opportunity to fully reply thereto. Show cause proceedings shall otherwise follow the provisions of this chapter with reference to contested cases, except where otherwise specifically prohibited.

Tenn. Code Ann. § 65-2-106 (emphasis added).

In this case, should a show cause order issue, it must state that the Authority has determined that Atmos' rates should be reduced by specific amount, and direct Atmos to appear and show cause why the Authority should not implement the particular reduction recommended by Staff. Therefore, in order for Staff to recommend that a show cause order issue, Staff must prepare a recommendation as to what Atmos' rates should be.

It is impossible for Staff to prepare such a recommendation simply by looking at the material submitted with the CAPD's Petition. The testimony of Dr. Stephen Brown submitted with the CAPD's Petition does not contain the full ratemaking analysis required under Tennessee law. The conclusions Dr. Brown reaches are not supported by fact. Rather than employing recognized methodology, Dr. Brown's analysis contains "calculations" which are not accepted methodology within the field, and which have been expressly rejected by the TRA, most recently in the Chattanooga Gas rate case. Dr. Brown's analysis consists solely of the following:

(1) *historical comparisons between the economic conditions predicted in Atmos' last rate and actual past economic conditions* – Even if Dr. Brown's comparisons were accurate, they are totally irrelevant. The TRA cannot adjust Atmos' rates going forward to correct for the fact the economy did not perform exactly as projected in the last rate case. Instead, the TRA must set rates for Atmos based on future projections for the Company's capital structure, cost of service, and capital requirements, not past economic performance. See South Central Bell v. Tennessee Pub. Serv. Comm'n, 579 S.W.2d 429 (Tenn. Ct. App. 1979).

(2) *historical comparisons between Atmos' past unadjusted, per book earnings and what Dr. Brown contends are market earnings for the same period* – Dr. Brown reported market returns hovering around 5% and never exceeding 10%. Dow Jones Industrials reported returns for the same period averaged 25%. This inconsistency alone requires that Dr. Brown's market conclusions be disregarded in their entirety.⁸

(3) *an unrealistic calculated beta value for Atmos using a calculation which is not a recognized methodology, and which was explicitly rejected by the TRA in the recent Chattanooga Gas case* – Reported betas for Atmos from reputable sources (Value Line and Thomson's) range from .70 to .86. Dr. Brown's own "calculated" beta for Atmos concludes, ridiculously, that Atmos' stock is only slightly more risky than U.S. Treasury Bonds and less risky than Atmos' own corporate debt.⁹

(4) *a DCF analysis that inexplicably concludes a 8.2% rate of equity ("ROE") for Atmos when Dr. Brown's own group of comparable gas companies, all of which have higher reported earnings and less measurable risk than Atmos, have allowed ROEs ranging from 10.5% to 11.5% --* As with his "calculated" beta, Dr. Brown ignored all signals of investor expectations reported by reputable independent financial analysts, and instead "calculated" measures of investor risk for his group of comparable companies that are much lower than both actual and allowed returns for those companies.¹⁰

(5) *a calculated rate of return for Atmos of 6.89%, using a "hypothetical" capital structure containing 12.8% short term debt, even though Atmos' actual short term debt ranges between 0-1% --* Like his beta and measures of investor risk, Dr. Brown's short term debt percentage is the result of his own "calculations."¹¹

The glaring errors and inaccurate information in Dr. Brown's testimony renders his analysis of no use with respect to the Staff's assigned task.

It is ridiculous to assume, as Mr. Walker does, that the Staff could complete its investigation in as little as 5 months. Staff audits of Actual Cost Adjustment and Incentive Plan

⁸ As noted above, Dr. Brown used Atmos' unadjusted, per-book returns. In the Company's last rate filing, Atmos' unadjusted historic rate of return of 11.48% decreased to 8.96% after adjustments. Atmos; Resp. to Consumer Advocate's Pet., p. 8.

⁹ Id.

¹⁰ Id. p. 9.

¹¹ Id. p. 10.

accounts take an average of 5-8 months. The investigation Staff has been asked to do in this case is much more complex, and the burden it must meet, much higher. As such, Mr. Walker's comments are, at best, misguided.

Given the onerous burden that has been placed on the Staff, Atmos agrees with Director Miller that the TRA's order directing the Staff investigation be reversed.

III. THE TRA SHOULD DECLINE TO CONVENE A CONTESTED CASE.

The Directors have suggested that perhaps the Authority should terminate the Staff investigation and treat the CAPD's Petition as one for a contested case, thereby placing the burden of proof on the CAPD. The CAPD has made it very clear that it does not want a contested case. In fact, the CAPD's position is that it should *not* be required to expend its resources in such a manner.¹²

Given the CAPD's position, Atmos submits that the TRA should amend its order to deny the CAPD's request for a Staff investigation, and direct the CAPD to file a new petition for a contested case should the CAPD determine it would be a worthwhile expenditure of resources. The CAPD has not requested such a remedy, and has in fact repeatedly expressed its desire to avoid precisely that result. The TRA should refrain from forcing the CAPD to expend its resources to pursue this case. Permitting the CAPD to file a new petition for a contested case will give the CAPD the opportunity to review the matter internally, and make a determination as to how to allocate its limited resources. In addition, given the high burden of proof applicable to the CAPD's allegations, convening a contested case over the objections of the CAPD may well be an exercise in futility, and quite simply, a waste of the TRA's time.

¹² CITE

In the alternative, Atmos proposes that the TRA amend its order to relieve Staff of the onerous duty to determine whether sufficient evidence exists to convene a show cause, and instead direct Staff to investigate whether sufficient cause exists to justify convening a contested case. Such an investigation is warranted given that convening a contested case would force the TRA and the Company to expend the significant man-hours necessary to advise and preside over a full rate case, which is a much more significant commitment of resources than for other contested cases.

The unique policy issues raised by the CAPD's allegations, and the heightened standard of proof that applies to those allegations provide additional reasons to direct Staff to determine if sufficient cause exists to merit convening a contested case over the objections of all parties. The rates the CAPD is challenging carry with them the same presumption of validity accorded legislative enactments. CF Indus. V. Tennessee Pub. Serv. Comm'n, 599 S.W.2d 536, 540 (Tenn. 1980); Southern Bell Telephone & Telegraph Co. v. Tennessee Pub. Serv. Comm'n, 304 S.W.2d 640, 649 (Tenn. 1957). The Tennessee Supreme Court has specifically held that in order to make a threshold, *prima facie* case to challenge rates set by the TRA, a petitioner must produce *convincing evidence of a substantial and material nature*. Cf Indus., 599 S.W.2d at 540; Southern Bell, 304 S.W.2d at 649.

The material submitted with the CAPD's Petition as evidence in support of its allegations falls far short of meeting this threshold requirement of a prima facie case. The CAPD's "evidence" consists of nothing more than hyperbolic rhetoric and faux economic analysis. In addition to Dr. Brown's calculations, the only other support the CAPD has offered for its request for the extraordinary relief of a full rate case is the testimony of Dan McCormac. Mr.

McCormac's testimony is wholly irrelevant and provides no credible support for the CAPD's allegations.

Mr. McCormac's testimony consisted solely of a list of TRA decisions dating back to 1984, each of which Mr. McCormac claims granted Atmos a "single issue rate increase." Mr. McCormac's assertions are absurd. His list of "single issue rate increases" consisted of decisions and filings which had zero impact on the amount Atmos earns on its investment in Tennessee, including the Company's routine PGA filings and the TRA's approval of the Goodyear contract, under which all margin amounts the Company receives from Goodyear are refunded 100% to consumers. Not incidentally, most of the decisions Mr. McCormac cites were entered over the objections of the CAPD. Mr. McCormac's list of grievances provides no support for the CAPD's allegations that Atmos' authorized rate is too high.

In Consumer Advocate v. Greer, the Tennessee Supreme Court held that the CAPD could not force the TRA to convene a contested case for matters on which *the utility* has the burden of proof simply by offering conclusory statements without factual support. Greer, 967 S.W.2d 759, 762 (Tenn. 1998). In this case, not only does the CAPD, and not the utility, have the burden of proof, but that burden is a heightened one. Cf Indus., 599 S.W.2d at 540; Southern Bell, 304 S.W.2d at 649. However, a review of the CAPD's supporting material reveals that the pages of rhetoric filed with the petition offer no facts in support of the CAPD's allegations.

The TRA's decision in this case will set the standard for the determining whether the CAPD has made the requisite prima facie showing of convincing and substantial evidence necessary to overcome the presumption of validity accorded the TRA's rate orders and force the TRA to conduct a full rate case. Given the paucity of support offered for the CAPD's allegations, convening a contested case at this point, without affording any opportunity for Staff

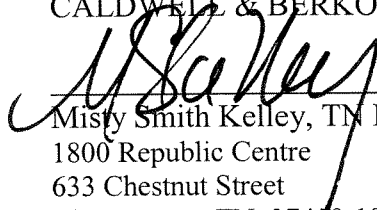
review, renders any threshold meaningless. If the CAPD can force a rate case simply by attaching the type of unsupported, illogical, and inaccurate statements submitted in this case, and by manufacturing public protest, then the CAPD can force a rate case against any utility, at any time. Requiring a Staff review of the material submitted will serve as a deterrent, and avoid placing the resources of the TRA, the utilities, and the ratepayers at the mercy of the CAPD.

IV. CONCLUSION.

Atmos agrees with Director Miller that the TRA's current Order directing TRA Staff to conduct an investigation to determine whether sufficient evidence exists to justify a show cause should be reversed. The Order creates an onerous burden on Staff. Staff cannot fulfill its obligations under the Order and the show cause statute without making a specific recommendation as to what would be a just and reasonable rate of return for Atmos. Contrary to the public statements of the CAPD and others, such a recommendation requires a complex, multi-faceted analysis of an enormous breadth of information, and cannot be completed in just a few months. In light of the CAPD's position that it should *not* be required to expend the necessary resources to meet the burden of proof for a contested case, the TRA should amend its order to deny the CAPD's request for a Staff investigation, and direct the CAPD to file a new petition for a contested case should the CAPD determine it would be a worthwhile expenditure of its limited resources. In the alternative, Atmos proposes that the TRA amend its order to relieve Staff of the onerous duty to determine whether sufficient evidence exists to convene a show cause, and instead direct Staff to investigate whether sufficient cause exists to justify convening a contested case. Such an investigation will permit full consideration of the wide ranging policy implications of the TRA's decision in this case.

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing has been mailed, postage prepaid, to the following parties of interest this 9th day of March, 2006.

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