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**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) Docket No. 05-00258
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)

**Atmos Energy Corporation's Response to
Report and Recommendation of Investigative Staff**

Atmos Energy Corporation ("Atmos" or the "Company") files this Response to the Report and Recommendation of Investigative Staff issued April 24, 2006.

I. **STAFF'S REPORT CORRECTLY CONCLUDES THAT THERE IS NOT
SUFFICIENT EVIDENCE TO JUSTIFY ISSUANCE OF A SHOW CAUSE ORDER
AGAINST ATMOS.**

The Authority's March 23, 2006 Order described Staff's task as "conducting an investigation to determine whether sufficient facts exist for the issuance of a show cause order."¹ Staff's conclusion is that there is *not* sufficient evidence to warrant a show cause order.² Staff's report indicates Staff agrees that, before issuing a show cause order in this case, the TRA must determine that the rates it has authorized for Atmos are not just and reasonable, which necessarily means that the TRA must also make a specific recommendation as to what Atmos' rates should be in the future.³ Staff's report cautions numerous times that Staff has not completed the required

¹ March 23, 2006 Order Granting Petition and Commencing Investigation, p. 6.

² Report and Recommendation of Investigative Staff, p. 17.

³ See Atmos' Resp. to Director Miller's Mot. to Reconsider, pp. 3-6; Atmos' Resp. to Consumer Advocate Pet., pp. 2-5.

analysis that would be necessary to make such a recommendation.⁴ Atmos agrees with Staff's conclusion that a show cause order is not justified, and requests that the Authority abide by Staff's recommendation not to issue a show cause order.

II. STAFF'S REPORT CORRECTLY FOUND THE CONSUMER ADVOCATE'S ALLEGATIONS UNPERSUASIVE.

The Authority's March 23, 2006 Order directed Staff to investigate the allegations contained in the Consumer Advocate's Petition and supporting documentation.⁵ Staff's Report indicates that Staff thoroughly examined the Consumer Advocate's allegations as well as the material the Consumer Advocate submitted in support of its allegations.⁶ It is apparent from Staff's Report, however, that Staff did not find the Consumer Advocate's allegations well-supported. Staff specifically notes that "[t]his Staff investigation does not verify the Consumer Advocate's claim that Atmos is overcharging consumers by approximately \$10.2 million annually."⁷ In addition, Staff did not rely on any of the Consumer Advocate's arguments or analyses in reaching its conclusions.

Atmos agrees that the Consumer Advocate's claims are unfounded, and do not provide any evidence relevant to determining whether Atmos' existing rates are not just and reasonable, and if so, what the new rates should be going forward. Much of the material sponsored by Consumer Advocate witness Dr. Brown was not a ratemaking analysis at all, but instead consisted of irrelevant historical comparisons between earnings and predictions made in Atmos' last rate case and what Dr. Brown represented as market conditions. Such historical comparisons are completely irrelevant to determining just and reasonable rates, which must be set based on future projections, not past economic performance. South Central Bell v. Tennessee Pub. Serv. Comm'n,

⁴ Report and Recommendation of Investigative Staff, pp. 8, 15-17.

⁵ March 23, 2006 Order Granting Petition and Commencing Investigation, p. 9.

⁶ Report and Recommendation of Investigative Staff, pp. 1-2; 16.

⁷ Report and Recommendation of Investigative Staff, p. 16.

579 S.W.2d 429 (Tenn. Ct. App. 1979). Perhaps even more importantly, Dr. Brown's market information was vastly different from all reputable reported market statistics, an inconsistency which raises questions about the reliability of the entirety of Dr. Brown's testimony.⁸ Dr. Brown's rate of return analysis did not follow valid, recognized ratemaking methodology and instead consisted of calculations which have been specifically rejected by the TRA as not included in any of the valid methods for determining rate of return.⁹

The remainder of the Consumer Advocate's supporting material consisted of a listing by Mr. McCormac of TRA decisions dating back to 1984, and the incorrect, and sometime absurd¹⁰, characterization of each of those decisions as "single issue rate increases," even though the decisions had zero impact on Atmos rate of return.

The Consumer Advocate's allegations are unfounded, were not relied upon by Staff for support of Staff's recommendations, and do not support the convening of any proceeding to examine Atmos' rates.

III. THERE IS INSUFFICIENT EVIDENCE TO SUPPORT STAFF'S RECOMMENDATION TO CONVENE A CONTESTED CASE.

Staff's recommendation urges the Authority to convene a contested case based on the Staff's analysis comparing:

- (1) Atmos' unadjusted earnings as of September 30, 2005 with
- (2) the amount the Company would earn if rates were set using the capital structure and debt costs in place on September 30, 2005 and the rate of equity the Authority approved for Chattanooga Gas.

⁸ For example, Dr. Brown reflected market returns for the broad market that hovered around 5% and never exceeded 10%, where the reported returns for the Dow-Jones Industrials averaged 25% for the same time period. See Atmos' Resp. to Consumer Advocate's Pet., p. 8 and Ex. A p. 13.

⁹ See 10/20/04 Order in Petition of Chattanooga Gas Company for Approval of Adjustment in Rates, Docket No. 04-00034, at p. 52.

¹⁰ For example, Mr. McCormac characterized Atmos' routine PGA filings to pass through the cost of gas to consumers as "single issue rate increases." See McCormac Aff. pp. 4-5.

Both sides of Staff's comparison are unreliable. Staff's Report acknowledges that the number used for the first side of the comparison, Atmos' unadjusted earnings as of September 30, 2005, is not the number that would be used to determine Atmos' rates going forward.¹¹ As noted in Staff's report, a determination of just and reasonable rates for Atmos would require a detailed forward-looking analysis and earnings forecast.¹² According to Staff, the ultimate result of such a forward-looking analysis could differ significantly from the amounts Staff used in its comparison in "several areas" that Staff characterizes as capable of having a "major impact" on the ultimate rates set for Atmos.¹³

The second side of the comparison, Staff's calculation of the amount the Company would hypothetically earn applying certain assumptions, is equally as flawed. Staff calculates the hypothetical earnings assuming that the Authority set rates for Atmos using a September 30, 2005 capital structure and debt costs and a rate of equity identical to that used for Chattanooga Gas. Staff's use of a snapshot capital structure and debt costs as of a single point in time is unrealistic. Atmos' capital structure, like that of most natural gas utilities, fluctuates during the year due in large part to borrowing during the fall to ensure adequate gas supply for the winter months. In a ratemaking proceeding, the capital structure used must reflect the anticipated capital structure for the entire future period during which the rates will be in effect, not a historical snapshot at a single point in time. See South Central Bell v. Tennessee Pub. Serv. Comm'n, 579 S.W. 2d 429 (Tenn. Ct. App. 1979) (holding that rates must take into account known future changes). Likewise, the

¹¹ Report and Recommendation of Investigative Staff, p. 15.

¹² Id.

¹³ Report and Recommendation of Investigative Staff, p. 15.

debt costs in existence on September 20, 2005 are not necessarily representative of the costs the Company will experience during the period the rates would be in effect.¹⁴

The Staff's use of the return on equity awarded Chattanooga Gas is also unsupported. Determination of the appropriate rate of equity is not a one-size-fits-all analysis. To compute the company's cost of equity, the TRA must determine the return investors earn in other enterprises having risk levels which correspond to those of Atmos. Tennessee-American Water Co., 1985 Tenn. App. Lexis at * 5. This determination must be made on a company-specific basis. 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)). Such rates cannot be set industry wide. See Consumer Advocate Division v. Tennessee Regulatory Authority, 1998 Tenn. App. Lexis 428 at *13 (Tenn. Ct. App. July 1, 1998) (cautioning that "the proper rate of return is not a point on a scale"); Bluefield Waterworks v. Public Svc. Comm'n, 262 U.S. 679, 693 (1923) ("no proper rate can be established for all cases"). The TRA must make a specific determination as to the rate of equity which will 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. (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)). Because the rate of return is so dependent on the financial characteristics of the particular company at issue, Tennessee law *requires* that the TRA consider the company's 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.

¹⁴ See Test. of D. Murry at p. 9 (noting that "reputable forecasters of both long-term and short-term interest rates are predicting rising rates for the next several years.")

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 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).

The fact that Chattanooga Gas and Atmos are both gas companies provides no support for the Staff’s position that the two companies are entitled to exactly the same rate of return. AARP, 896 S.W.2d at 132. In order to sustain its claim that the two companies’ rates of equity should be identical, Staff would have to show that Atmos and Chattanooga Gas have identical investment risk. Tennessee-American Water Co., 1985 Tenn. App. Lexis 2800 at * 5; AARP, 896 S.W.2d at 132. Staff’s Report contains no analysis of the relative investments risk of the two companies.

In fact, the evidence submitted earlier in this docket demonstrates that Atmos and Chattanooga Gas do not have identical levels of risk. Dr. Donald Murry testified that Atmos’ common stock return is lower than Dr. Brown’s group of comparable companies, which included Chattanooga Gas’s parent, Atlanta Gas Light.¹⁵ Dr. Murry’s schedules reflect Atmos with a 11.4% return compared to Atlanta Gas Light’s 14.43% return.¹⁶ Dr. Murry also testified that virtually every measure of industry risk ranks Atmos as more risky than Dr. Brown’s comparable companies, including Atlanta Gas Light.¹⁷ Atmos earn less and carries more risk than Atlanta Gas Light, so Atmos is entitled to a higher return on equity than Chattanooga Gas, not an identical one.

¹⁵ Test. of D. Murry, p. 10 and Schedule DAM 6.

¹⁶ Schedule DAM 6.

¹⁷ Test. of D. Murry, p. 11.

IV. **THE AUTHORITY SHOULD REJECT STAFF'S RECOMMENDATION.**

Staff's sole reliance on the rate of equity awarded Chattanooga Gas brings this docket full circle back to the Consumer Advocate's first petition in 2004. The only proof the Consumer Advocate submitted with its first petition was a reference to the lower return granted Chattanooga Gas, together with a comparison similar to the one performed by Staff in its Report.¹⁸ In its 2004 Response, Atmos noted that if all that is required to force the TRA and a utility into an expensive and time-consuming rate case is a point to a lower return granted another utility, then the TRA's rate orders have no finality, and would be constantly subject to attack. Atmos demonstrated in its 2004 Response that the TRA cannot set rates by comparison, but is legally required to conduct a company-specific analysis. After receiving Atmos' response, the TRA found the Consumer Advocate had not presented sufficient evidence in support of its petition.¹⁹ After 2 years and an enormous expenditure of resources, we are right back where we started. Reference to a lower return granted Chattanooga Gas was insufficient to justify convening a case in 2004, and it remains just as insufficient today. Therefore, Atmos requests that the Authority reject Staff's recommendation and direct the Consumer Advocate to file a new petition with sufficient supporting proof if it wishes to proceed.

V. **IF THE AUTHORITY ACCEPTS STAFF'S RECOMMENDATION TO CONVENE A CONTESTED CASE, THE BURDEN OF PROOF MAY NOT BE SHIFTED TO ATMOS, EITHER DIRECTLY OR INDIRECTLY.**

If the Authority accepts Staff's recommendation to convene a contested case, the proceedings must be structured to ensure that the burden of proof is not shifted to Atmos, either directly or indirectly. Staff's Report recommends that a contested case be convened to permit Staff, as a party, together with any intervenors, the opportunity to present recommended rates for

¹⁸ Pet. to Require Atmos to Appear and Show Cause that Its Rates are Just and Reasonable, Docket No. 04-00356, p. 2.

¹⁹ Order Denying Petition, Docket No. 04-00356.

Atmos.²⁰ Although Staff's Report does not address which party will have the burden of proof, the omission of Atmos from the list of parties to present proof presumably connotes Staff's intention to assume the burden of proof itself, perhaps together with the Consumer Advocate as intervenor. Staff has clearly found insufficient evidence to justify issuance of show cause order. Absent a show cause order, the burden of proof may not be shifted to Atmos. Tenn. Code Ann. § 65-2-109; Tenn. Comp. R. & Regs. 1220-1-2-.16 (placing the burden of proof in TRA proceedings on the party seeking relief); Illinois Central Gulf RR Co. v. Tennessee Public Svc. Comm'n, 736 S.W.2d 112, 118 (Tenn. Ct. App. 1987) (noting that state legislature, not PSC, is the entity with the authority to shift the burden of proof as a matter of policy). Shifting the burden of proof without a show cause order would violate the constitutional guarantee to due process. See Williams v. Pittard, 604 S.W.2d 845, 849-50 (Tenn. 1980).

As noted in previous filings, the rates currently in place for Atmos were set by TRA order, which is accorded the same presumption of validity under the law as 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). Therefore, Staff and any intervenors must meet the "heavy burden" of presenting convincing evidence of a substantial and material nature. CF Indus., 599 S.W.2d at 540; Southern Bell, 304 S.W.2d at 349. Any order convening a contested case should reflect this heightened burden of proof, and confirm that the burden lies with Staff and any intervenors.

In addition, the procedure must protect against an implicit shifting of the burden of proof to Atmos. The only way to avoid imposing the burden of proof on Atmos together with Staff and the intervenors is to bifurcate the proceedings into two phases. The first phase should permit Staff and any intervenors to submit testimony and evidence in support of what they contend is a just and

²⁰ Report and Recommendation of Investigative Staff at p. 17.

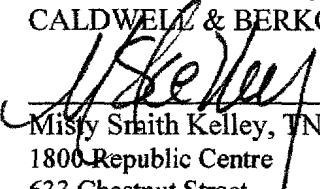
reasonable rate for Atmos, and give Atmos the opportunity to challenge, through rebuttal testimony and cross-examination, whether the burden of proof necessary to show Atmos' existing rates are invalid has been met. The procedural schedule should allow the parties the opportunity to present motions for summary judgment on this legal issue. Only after a final determination that the Staff and intervenors have met their burden to show that Atmos' existing rates are not just and reasonable should Atmos be required to present an affirmative rate case to establish what it contends its rates should be going forward. Such a procedure is the only way to avoid implicitly shifting the burden of proof to Atmos in violation of the Tennessee statutes, TRA rules and constitutional due process guarantees.

VI. CONCLUSION.

Atmos agrees with Staff that there is insufficient evidence to justify issuance of a show cause order, and requests that the Authority accept Staff's recommendation not to convene a show cause. Atmos agrees that the Consumer Advocate's allegations are unfounded. The allegations were not relied upon by Staff, and do not support the convening of any proceeding to examine Atmos' rates. Staff's report relies only upon a comparison of Atmos' rates with Chattanooga Gas, which is insufficient to justify Staff's recommendation to convene a contested case. As such, Atmos requests that the proceedings be dismissed. In the alternative, should the Authority accept Staff's recommendation to convene a contested case, the proceedings must be bifurcated into two phases to avoid impermissibly shifting the burden of proof to Atmos.

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 10th day of May, 2006.

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