

**BEFORE 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

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**COMMENTS OF THE CONSUMER ADVOCATE ON THE REPORT AND
RECOMMENDATION OF INVESTIGATIVE STAFF**

The Tennessee Attorney General, by and through the Consumer Advocate and Protection Division ("Consumer Advocate"), submits the following comments in response to the "Report and Recommendation of Investigative Staff" filed with the Authority on April 24, 2006.

The Consumer Advocate has two main comments on the Report: (1) first, the Consumer Advocate welcomes the staff's finding that Atmos is indeed overearning as asserted by the Consumer Advocate; however, (2) the Consumer Advocate disagrees with the Report's suggestion that a contested case is to be preferred over a show cause proceeding. The Consumer Advocate still believes that a show cause proceeding is the most expeditious and effective means of ensuring that consumers receive the just and reasonable rates to which they are entitled.

1. The Staff Report Confirms That Atmos Is Overearning

The Report of the Investigative Staff confirms the findings of the Consumer Advocate set forth in the Consumer Advocate's Petition filed September 16, 2005. The pattern of excess earnings identified by the Consumer Advocate for the twelve-month period ending September 30, 2004, has continued through the twelve-month period ending September 30, 2005. Even using the Staff's more

conservative estimate of what constitutes a fair return on equity, Atmos has earned about 18 million dollars in excess profits during the two-year period ending September 30, 2005. Based on that evidence, the Authority has a clear legal duty to take action to reduce the company's earnings.

2. A Show Cause Is Still the Most Effective Procedure

The Report suggests that the Authority initiate a contested case proceeding in which the Investigative Staff, participating as a party, will present evidence concerning Atmos' annual revenue requirement. In addition, the Report suggests that it is premature for the Authority to issue a formal "show cause" order pursuant to Tenn. Code Ann. § 65-2-106 because the Investigative Staff has not yet done a forecast of the company's earnings or a more detailed, rate-of-return analysis. Report at page 17. The Report implies that a show cause proceeding might properly be initiated after such additional investigation has been completed.

The Consumer Advocate, however, believes that the findings in the Staff's Report are sufficient to support the issuance of a show cause order as a matter of law.¹ The Staff's report confirms that the Consumer Advocate has carried the initial burden of demonstrating that the rates charged by Atmos are not just and reasonable and are, therefore, in violation of Tennessee Code Annotated §§ 65-5-104(a)(1) and 65-5-101. Accordingly, there is no reason for the TRA to refrain from using the power given to it by the Legislature in Tenn. Code Ann. § 65-2-106 to conduct a show cause proceeding.

¹See AARP v. Tennessee Public Service Commission, 896 S.W.2d 127 (Tenn. Ct. App. 1994) cert. den. Feb. 27, 1995. In that case, the court noted that state regulators are free to use a historical test period in setting rates and are not required to use a forecast period. Id., at 133-134. The Staff's Report is consistent with that approach. The Court also held that the "critical inquiry" in establishing a fair rate-of-return is to examine "the return on equity in enterprises having comparable risk." The uncontested testimony of the Consumer Advocate, using a comparable risk analysis, sets an appropriate return of equity of 8.2%. The Staff's use of the return established for Chattanooga Gas, a company whose risk was recently examined by the TRA, is a valid and legally defensible analysis to establish a fair return for Atmos.

The TRA's predecessor agency, the Tennessee Public Service Commission, instituted a number of show cause proceedings, including cases involving overearnings investigations. For example, in In Re: Show Cause Order Against GTE South, Docket No. 92-16134, the PSC explicitly directed the telephone company GTE South “to appear and show cause why the Company should not reduce its rates to a just and reasonable level.” Show Cause Order Against GTE South (“GTE Show Cause Order”), Docket No. 92-16134, January 11, 1993, at page 1 (copy attached as **Exhibit A**). This show cause proceeding followed a rate case in which the company, according to the PSC staff, filed erroneous information that increased their expenses; in order to correct the impact of the erroneous information a show cause proceeding was instituted. In addition to supporting the principle that show cause proceedings are proper in earnings reviews, the case also is relevant for the procedural schedule which it sets forth. The show cause order was issued on January 11, 1993. GTE was given until February 8, 1993, to file testimony. The PSC staff had until March 1, 1993, to file its testimony. The hearing was set for March 23, 1993, less than four months after the issuance of the show cause order.

Finally, the Consumer Advocate believes that a show cause proceeding will, in fact, be quicker than the suggested contested case because there exists a strong possibility of resistance to discovery by Atmos. In the present circumstance, there is no doubt that Atmos is overearning. This utility has been earning substantial excess profits for far too long and has a financial incentive to prolong these proceedings. The best course is for the Authority to direct Atmos to show cause by pre-filed testimony within no more than thirty (30) days as to why its rates should not be adjusted. With the filing of its pre-filed testimony, Atmos should provide full and accurate responses to the data requests found in the minimum filing guidelines. It is equally important that a schedule for

discovery, interventions, other pre-filed testimony, and the hearing be set as soon as possible.

If, however, the Authority chooses to open a contested case, it is critical that the Authority proceed expeditiously. In light of the Staff's findings that Atmos is overearning and consumers are thereby overpaying, it is incumbent on the TRA to set forth an accelerated procedural schedule. Until rates are adjusted it is most likely that consumers will never recover the money they are overpaying. At the latest, the hearing should be completed and new rates put into effect before the October 2006 heating season. Discovery disputes should be resolved as quickly as possible and parties should be prepared to meet, if necessary, at times other than regularly scheduled TRA conferences.

Respectfully submitted,

Paul G. Summers
Attorney General
State of Tennessee

A handwritten signature in cursive script, reading "Vance L. Broemel", written over a horizontal line.

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CERTIFICATE OF SERVICE

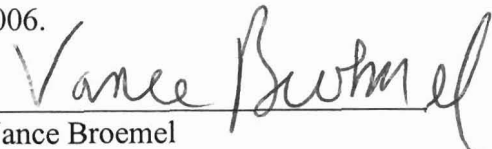
I hereby certify that a copy of the foregoing is being forwarded via U.S. mail, to:

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on this the 10th day of May, 2006.

Vance Broemel

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BEFORE THE TENNESSEE PUBLIC SERVICE COMMISSION
Nashville, Tennessee
JANUARY 11, 1993

IN RE: SHOW CAUSE ORDER AGAINST GTE SOUTH
DOCKET NO. 92-16134

FILE COPY

ORDER **DO NOT REMOVE**

This matter is before the Tennessee Public Service Commission on its own motion pursuant to T.C.A. Section 65-2-106. The Commission directs GTE South (GTE or Company) to appear and show cause why the Company should not reduce its rates to a just and reasonable level.

Based on a preliminary investigation of this matter, the Commission concludes the following:

1. Pursuant to a previous earnings review, the Commission requested that GTE submit to a management audit. Upon GTE's agreement, an independent consulting group conducted the management audit. The independent consulting group, Theodore Barry & Associates (TB&A), completed the audit in August 1992. As a part of that audit, the consultants examined the methods GTE uses to allocate costs to Tennessee from other states. The consultants examined eighteen (18) specific accounts in which charges are allocated to Tennessee customers from other states. The consultants concluded that, in several of the accounts studied, GTE is allocating costs based on general allocation factors rather than on a cost-causative basis. The consultants recommended more cost-causative methods of allocation for eleven (11) of those accounts, and recommended disallowances of expenses in five (5) other accounts. Those accounts and the proposed adjustments are listed on Exhibit A. The findings of the consultants concerning those specific accounts, if adopted, would reduce the operation and

maintenance expenses of GTE in Tennessee by approximately \$678,400 per year and would result in immediate rate decreases to Tennessee customers.

The management audit also discusses several more general non-quantifiable corporate concerns. The Commission is taking no action on those concerns at this time, and neither endorses nor rejects the auditors' recommendations on those issues. The purpose of this proceeding is to address the auditors' proposed adjustments on the accounts listed in Exhibit A./1

2. In a separate investigation, the Commission has determined that, as a result of misleading information provided by the Company to the Staff during the Company's last rate case (Docket No. 91-05738, Order issued September 27, 1991), the Company is presently earning an excessive and unreasonable return.

In July, 1991, as a part of the Staff's investigation of the Company's rates, the Staff determined that GTE's expenses had dropped significantly due to increased charges allocated to other states and decreased charges allocated to Tennessee from other GTE affiliates. At that time the Company stated that its expenses had not dropped, but that the Company books were incorrect. The Company stated that correcting entries, which would increase the Company's expenses in Tennessee, needed to be made to GTE's books and should be incorporated in the Staff's forecast of the Company's expenses during the forecast period, 1991-1993. Based on the Company's assurance that the books were incorrect, the Staff agreed to increase its estimate of the Company's expenses during the forecast period. The parties eventually settled

/1 To the extent that the parties have already initiated discovery regarding other management audit issues, those discovery requests not related to the accounts listed on Exhibit A need not be answered.

the rate case based on the Staff's forecast and an agreed rate of return of 10.85% and a return on equity of 14.00%.

During the rate case, GTE also provided information to the Staff regarding projected savings that would occur during the forecast period as a result of GTE's merger with Contel, and as a result of other reorganization and allocation methodology changes. The Staff incorporated that information into its forecast of the Company's earnings.

In early 1992 the Company met with the Staff and acknowledged that the correcting entries to GTE's books had not been made for 1991. GTE assured the Staff, however, that 1992 costs would be allocated properly and would therefore closely mirror the expense figures used in the Staff's forecast.

In April, 1992, the Staff and GTE met again. This time GTE acknowledged that the Company's expenses would continue to remain significantly below the expense level used in the rate case. GTE also acknowledged that the Company had significantly understated the projected merger and reorganization savings. GTE agreed to work with the Staff to quantify the effects of the incorrect information on the Company's rates and to make the necessary adjustments to earnings effective January 1, 1992. GTE also asked the Staff to postpone further investigation of these issues until after the Company responded to the ongoing management audit. In reliance on the Company's agreement to make the adjustments effective January 1, 1992, the Staff agreed to the postponement.

The Company and the Staff met again in October, 1992, but were unable to agree on how to quantify the impact of the erroneous figures used in the Staff's forecast.

The Staff has calculated the excess rates caused by the incorrect information to be \$2,904,789 per year. The Company's books indicate that

the Company is presently earning a return on equity of 25.6% (Exhibit B & C).^{/2} These over-earnings will continue until the effects of the incorrect information are corrected.

3. As a result of the recommendations of TB&A and of the misleading information incorporated in the Staff's forecast, GTE is charging Tennessee customers a total of \$3,583,189 a year in excess rates.

4. GTE is directed to appear on March 23, 1993 at 9:30 a.m. in the Commission hearing room, 460 James Robertson Parkway, Nashville, Tennessee, and show cause why the Company should not reduce its annual revenue by \$2,904,789, effective January 1, 1992,^{/3} and to reduce its revenue by an additional \$678,400 per year on a prospective basis. The procedural schedule is established as follows:

-GTE shall file all pre-filed testimony in response to this show cause order by February 8, 1993.

-The Staff shall file its pre-filed testimony by March 1, 1993.

-GTE shall file rebuttal testimony by March 15, 1993.

IT IS THEREFORE ORDERED:

1. That GTE shall appear and show cause why its rates should not be reduced to a just and reasonable level as described in this order.

2. That a hearing will be held on this matter on March 23, 1993.

3. That the hearing and all discovery will be limited to the issues described in this order.

^{/2} Additionally, the Company has explained that GTE's year-to-date expenses and rate of return are understated due to \$616,000 that has been overcharged to labor expense accounts from clearing accounts. Thus, GTE is earning in excess of what the Company's own records indicate.

^{/3} A portion of this amount is subject to the sharing mechanism outlined in the Regulatory Reform Plan.

4. That this docket shall remain open for such further Orders as the Commission directs.


CHAIRMAN


COMMISSIONER


COMMISSIONER

ATTEST:

EXECUTIVE DIRECTOR

GTE SOUTH MANAGEMENT AUDIT ADJUSTMENTS

Account	Name	Intrastate Amount a/	Allocation Basis	
			Used by Company	TB&A Cost Causitive
6113	Aircraft	(\$25,400)	Big 3 Expenses	% of Actual Hours for TN.
6124	General Purpose Computer	(223,300)	Big 3 Expenses	Usage
6611	Product Management	(38,400)	Current Billings	% of Premium Service
6612	Sales Expense	(14,800)	Current Billings	Current Business Revenue
6613	Product Advertising	(90,400)	Current Billings	Direct Charge
6623	Customer Service	(67,400)	Multiple Basis	No Change
6722	External Relations	19,800	Big 3 Expenses	% of Access Lines
6723	Human Resources	(35,600)	Big 3 Expenses	Employee Head Count
6724	Information Management	56,200	Big 3 Expenses	Usage
6727	Research & Development	1,500	Big 3 Expenses	% of Access Lines
6728	Other General & Admin.	(3,500)	Big 3 Expenses	% of Labor Charge
6124	General Purpose Computer &			10% disallowance
6724	Information Management	(58,500)b/		based on value of service.
6534	Plant Operations Admin Exp.	(146,100)		Disallowance based on value of service received.
6722	External Relations	(44,800)		One full time position not justified.
6612	Sales Expense	(7,700)c/		Cost recorded in incorrect account.
Total		<u>(\$678,400)</u>		

a/ Combined amounts from TB&A Report Exhibit II-3 separated using TB&A provided separation factors. In the program used by TB&A to compute the revenue requirement impact a change in some accounts will result in a change in the intrastate allocation of other accounts. As a result the total intrastate impact of the adjustments separated on an individual basis as above is different than the total amount shown in the report.

b/ TB&A adjusted accounts 6724 and 6124. In the last earnings review \$230,000 of the cost of computer service provided by an affiliate was disallowed. The \$58,500 adjustment reflected the net of the TB&A adjustments and the adjustment made in the earnings review.

c/ GTE South did not disagree with this adjustment in its comments to the audit report.

TENNESSEE PUBLIC SERVICE COMMISSION
 GTE SOUTH - TENNESSEE
 PROJECTED INCOME STATEMENT - INTRASTATE
 FOR THE YEAR ENDING DECEMBER 31, 1992
 (000 omitted)

	(1) ACTUAL COMMISSION FORECAST 1992	(2) ANNUAL MANAGEMENT AUDIT ADJUSTMENT	(3) ANNUAL FORECAST CORRECTION	(4) ADJUSTED COMMISSION FORECAST 1992	(5) ACTUAL 12 MONTHS ENDED SEPT 1992	(6) ANNUAL MANAGEMENT AUDIT ADJUSTMENT	(7) OTHER STAFF ADJUSTMENTS	(8) ADJUSTED 12 MONTHS ENDED SEPT 1992
Revenue	\$							
Local	15,214		\$	\$ 15,214	14,927	\$		14,927
Access	4,520			4,520	5,583			5,583
Toll	9,936			9,936	8,141			8,141
Miscellaneous	471			471	1,310			1,310
Uncollectible	290			290	732		(442)	290
	\$							
TOTAL REVENUES	29,851	0	0	29,851	29,229	0	442	29,671
Expenses	\$							
Operations & Maintenance	16,186	(678)	(2,904)	12,604	13,851	(678)	(616)	12,557
Depreciation	6,309	0	0	6,309	6,189	0	0	6,189
Other Operating Taxes	1,273	41	174	1,489	909	41	63	1,013
FIT	1,152	217	928	2,297	1,967	217	338	2,522
	\$							
TOTAL EXPENSES	24,920	(420)	(1,802)	22,698	22,916	(421)	(214)	22,281
	\$							
Net Operating Income	4,931	420	1,802	7,153	6,313	421	656	7,390
	\$							
COMMISSION ADJS.	707	0	0	707	547	0	0	547
	\$							
TOTAL ADJUSTMENTS	707	0	0	707	547	0	0	547
	\$							
Adjusted NOI	5,638	420	1,802	7,860	6,860	421	656	7,937
	\$							
Rate Base	51,966	0	0	51,966	52,120	0	0	52,120
Rate of Return	10.85%			15.12%	13.16%			15.23%
Fair Rate of Return	10.85%			10.85%	10.85%			10.85%
	\$							
NOI Surplus (Deficit)	(0)			2,221	1,205			2,282
Retention Factor	60.86%			60.86%	60.86%			60.86%
	\$							
Revenue Surplus (Deficit)	0			3,650	1,980			3,750
	=====			=====	=====			=====

GTE SOUTH

TENNESSEE INTRASTATE OPERATIONS

REGULATED EXPENSE NORMALIZED PER COMPANY 6/30/91	\$	3,933,127
REGULATED EXPENSE PER BOOKS 6/30/92		3,204,322
		<hr/>
DIFFERENCE		728,805
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ANNUAL EFFECT		1,457,610
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GROSSED UP AMOUNT FOR BENEFITS @1.183		1,724,353
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INTRASTATE AMOUNT @79.97%		1,378,965
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LOADING EFFECT @110.65%		2,904,789
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ALLOCATION CORRECTIONS		678,400
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TOTAL ANNUAL FORECAST AND ALLOCATION AMOUNT		<u>\$3,583,189</u>