BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

IN RE:

PETITION OF ATMOS ENERGY	)	
CORPORATION FOR APPROVAL OF	)	
ADJUSTMENT OF ITS RATES AND	)	
REVISED TARIFF	)	**DOCKET NO. 07-________**

JOHN R. ELLERMAN

I. POSITION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME, BUSINESS AFFILIATION AND BUSINESS ADDRESS.

A. My name is John R. Ellerman. I am employed by the international management consulting firm of Towers Perrin. I am a Managing Principal with the firm and I have responsibility for leading the executive compensation and rewards consulting practice of Towers Perrin for the Western Region of the United States. My business address is 12377 Merit Drive, Suite 1200, Dallas, Texas 75251.

Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND DESCRIBE YOUR WORK EXPERIENCE.

A. I have both B.B.A. and M.B.A. degrees from Stetson University. I have held an appointment to the Division of Sponsored Research at M.I.T. I have also served two years in the Department of Defense as a systems analyst in Washington D.C. Prior to joining Towers Perrin, I was a senior management consultant in the general management strategy practice of KPMG Peat Marwick for five years.

I joined Towers Perrin in 1978 as a compensation consultant in our firm's Atlanta office. I was transferred to the firm's Tampa office in 1981 where I initiated our firm's compensation consulting practice in Florida. I was elected Principal in 1983 and a Vice President in 1988.

Q. WHAT ARE YOUR JOB RESPONSIBILITIES?

A. I have specialized in the executive compensation area for the past 30 years. I consult with *Fortune 500* companies, including Atmos Energy Corporation ("Atmos" or the "Company"), on a daily basis regarding executive pay matters. I also have specialized in the design of incentive compensation plans that align company performance with reward opportunities. My clients are predominantly in the energy services sector.

I am also a frequent speaker on executive compensation and have given presentations at national forums of the Edison Electric Institute, the Conference Board, World at Work and other prominent groups.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE TENNESSEE REGULATORY AUTHORITY ("TRA") OR OTHER REGULATORY ENTITIES?

A. I have never testified before the TRA. However, I have testified before the Kansas Corporation Commission and the Oklahoma Corporation Commission.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to sponsor the Company's inclusion of certain incentive compensation costs in this rate proceeding and to explain why such costs and the inclusion thereof is reasonable and necessary.

II. SUMMARY

Q. WHAT SUBJECT AREAS DO YOU INTEND TO COVER IN YOUR TESTIMONY?

A. I will testify concerning the following subject areas:

1. Overview of the Company's incentive compensation plans.
    a. Variable Pay Plan ("VPP").
    b. Management Incentive Plan ("MIP").
    c. Long-Term Incentive Plan for Management ("LTIP").
2. Benefits of incentive compensation.
3. Inclusion of the cost of variable incentive compensation plans for management and non-management employees as part of the cost of service in setting rates.

Q. PLEASE SUMMARIZE YOUR TESTIMONY IN THESE SUBJECT AREAS:

A.

- The Company's inclusion of incentive compensation costs in this rate proceeding is both reasonable and necessary.
- The Company's Variable Pay Plan ("VPP") is a broad based incentive compensation plan in which virtually all employees of the Company participate, except for those that are included in the Management Incentive Plan ("MIP"). The VPP provides all eligible employees of the Company with the opportunity to earn a cash-based incentive award based upon the Company's return on equity performance which is expressed to plan participants as a target for Earnings Per Share (EPS).
- The VPP provides awards equal to 1% of base compensation for the threshold level of performance and the maximum level of performance results in a payment of 3% of base compensation. Base compensation is defined in terms of the VPP as base salary plus other forms of base compensation (e.g., overtime and other premium pay rates).
- The VPP plan offers award opportunities only when the Company reaches or exceeds desired levels of profitability as measured by both return on equity and earnings per share.
- Earnings Per Share (EPS) is determined by dividing the Company's net income by the total shares outstanding. Plan participants are aware that net income is a function of both maximizing revenues and minimizing expenses and that the best way for an employee to influence EPS results is to be mindful of unnecessary costs, customer service levels, safety incidents and productivity. These actions are beneficial to all constituents of Atmos Energy: ratepayers, shareholders, employees and communities the Company serves.
- The Management Incentive Plan ("MIP") is an extension of the VPP and is limited to a select group of management employees who are responsible for directing and overseeing the day-to-day operations of the Company.

The MIP provides the management team with the opportunity to earn a cash-based incentive award based upon the Company's return on equity performance which is expressed to participants in the plan as an EPS target.

- Participants in the plan receive a target award opportunity each year expressed as a percentage of base compensation. Base compensation is defined for purposes of the MIP as base salary. These target award opportunity percentages are directly tied to the 50th percentile of competitive market survey data for positions of comparable responsibility for energy services companies of similar size.
- The annual performance targets for the MIP are the same performance targets used by the VPP as determined by a return on equity target converted to an EPS target.
- The MIP plan pays awards only when the Company reaches or exceeds desired levels of profitability as measured by both return on equity and earnings per share.
- The Long-Term Incentive Plan ("LTIP") for management is an equity-based incentive program which focuses upon the long-term strength and financial viability of the Company. The LTIP provides incentives to the management team in two forms, time-lapse restricted shares and performance-based restricted share units.
- The time-lapse restricted shares are subject to a three-year restricted period. The shares are paid to the participant free of restrictions following the three-year service period from the date of grant.
- The performance-based restricted share units must be earned over a three-year performance period.
- The performance measure is the Company's cumulative three-year earnings per share compared to the planned or targeted level of EPS for the same period.
- Incentive compensation is a variable cost, as opposed to a fixed element of cost, and the variable element of pay is awarded only when the Company

can justify and afford to make such payments based upon its financial performance.

- The Company's pay for performance philosophy incorporates the use of incentive compensation for all employees. Incentive pay improves the Company's ability to recruit and retain talented employees, since incentive compensation is widely prevalent in the labor markets in which the Company competes for key talent.
- Annual incentive plans for both management and non-management employees have become particularly prevalent throughout the gas utility industry.
- A 2005 American Gas Association ("AGA") survey of sixty-one (61) companies found that 90% of the surveyed companies have one or more types of incentive compensation plans. The surveyed companies rated their incentive plans as successful.
- Earnings per share goals are met not only by increasing revenues, but also by minimizing expenses. If the Company's management can eliminate or minimize unnecessary costs, reduce the number of accidents and safety incidents, deliver satisfactory customer service with reasonable expense and staff levels, and improve performance by increasing productivity, the Company's earnings per share will be increased, and shareholders, customers, employees and the communities served by the Company will all benefit.
- Both ratepayers and shareholders should recognize the full cost of incentive compensation, since it is to the mutual benefit of both constituents.
- In our experience, my firm and I have found that variable incentive compensation plans benefit all stakeholders--customers, shareholders and employees. The cost of incentive compensation plans is a variable expense and is tied to improvements in productivity, service, cost management, and other performance factors that drive a company's financial strength and success.

- Disallowance of the Company's incentive compensation costs as part of its cost of service would place the Company at a competitive disadvantage. Those industries that are not regulated utilities are free to factor in the cost of incentive compensation into the price of the products or services they sell. If Atmos is not permitted to factor in the cost of its incentive compensation programs in the setting of rates in this proceeding, the Company will be placed at a competitive disadvantage.
- If the rate set in this proceeding does not take into account the amount of expense that the Company must incur to fund these programs and to be competitive in the employment market, the rate set would not meet the goal of fair and effective regulation.
- If the TRA were to disallow any or all of the costs of the Company's incentive pay compensation plans to be recovered in its rates, the Company's employee compensation costs reflected in the cost of service would be below the average for the market and would result in levels in the cost of service that are not reasonable when compared to that market.

III. OVERVIEW OF THE COMPANY'S INCENTIVE COMPENSATION PLANS

Q. ARE YOU FAMILIAR WITH THE COMPANY'S INCENTIVE COMPENSATION PLANS?

A. Yes. The Company has three such plans – the Variable Pay Plan, the Management Incentive Plan and the Long Term Incentive Plan for Management.

Q. WHAT IS THE VARIABLE PAY PLAN?

A. The Variable Pay Plan, or "VPP", is a broad based incentive compensation plan in which virtually all employees of the Company participate (except for those included in the Management Incentive Plan or the "MIP"). The plan, which is developed around the same precepts as the MIP, provides all eligible employees with the opportunity to earn a cash-based incentive award based upon the

Company's return on equity performance which is expressed to participants as an earnings per share target (EPS).

Q. WHAT COMPANY EMPLOYEES ARE ELIGIBLE TO PARTICIPATE IN THE VPP?

A. With one exception, all Company employees that do not participate in the MIP plan participate in the VPP. The exception rests with a group of collective bargaining employees in Mississippi (reference, Mississippi Local Union 1047C) that has not bargained to participate in the VPP plan. It should be noted that the Company's other bargaining unit has negotiated with management to participate in the VPP plan.

Q. WHAT FORM OF AWARDS ARE MADE PURSUANT TO THE VPP?

A. The VPP pays an annual cash award which is targeted to be 2 percent of base salary plus other forms of base compensation (e.g., overtime and other premium pay rates are included in the determination of base compensation). Should the Company attain its target level of EPS during the course of the fiscal year, the plan will pay cash awards following the September 30 close of the fiscal year. Typically, such awards are paid to participants in the form of cash awards in November following the close of the Company's financial reporting. The plan also pays awards for determination of threshold and maximum levels of performance. The plan provides awards equal to 1 percent of base compensation for the threshold level of performance, and the maximum level of performance results in a payment of 3 percent of base compensation. Awards under the VPP are capped at 3 percent of base compensation. For performance levels achieved which are between the stated threshold, target, and maximum levels of performance, awards are calculated on a straight line interpolated basis.

Q. HOW ARE THE APPLICABLE THRESHOLDS FOR AWARDS UNDER THE VPP DETERMINED?

A. The range of outcomes between threshold, target, and maximum are based upon the Company's budgeted return on equity at target and moving 100 basis points below budgeted return on equity for the threshold and 100 basis points above budgeted ROE for maximum performance. As an example, the following schedule sets forth the determination of the performance levels of threshold, target, and maximum performance targets for the VPP for the fiscal year 2006 plan year:

VPP Performance Schedule – 2006 Fiscal Year				
Performance Level	*Annual EPS*	*ROE*	*Basis for Performance Target*	*Payout as Percent of Base Compensation*
Threshold	$1.59	8.00%	100 basis points below budget ROE	1%
Target	$1.80	9.00%	2006 Budget	2%
Maximum	$2.01	10.0%	100 basis points above budget ROE	3%

As designed, the plan offers award opportunities only when the Company reaches or exceeds desired levels of profitability as measured by both return on equity and earnings per share. For participants, the performance targets are expressed only as levels of EPS so that participants have a clear line of sight to what they are being measured for as well as how they can influence results.

Q. HOW CAN VPP PARTICIPANTS INFLUENCE EPS RESULTS?

A. EPS is measured as the Company's net income divided by total shares outstanding. Participants understand that net income is a function of both revenues and expenses, and that the best way in which they can influence EPS results is being mindful of unnecessary costs, customer service levels, safety incidents, and productivity. These actions are beneficial to all constituents of Atmos: ratepayers, shareholders, employees and the communities served by the Company. Those who argue that EPS is only a measure which benefits a company's shareholders are shortsighted in understanding those factors and behaviors which have a direct bearing on EPS and who benefits therefrom.

Q. HAS THE COMPANY HISTORICALLY MADE AWARDS PURSUANT TO THE VPP TO PLAN PARTICIPANTS?

A. Yes. The VPP was developed in concert with the Company's development and adoption of a new overall compensation strategy set forth in 1998 and referred to as "Total Rewards." The plan was initially implemented in fiscal year 1999 and the plan paid no awards for that year since the Company failed to reach its threshold level of EPS performance. The Company also failed to reach the threshold level of EPS in fiscal year 2000, and no awards were paid in that year as well. The plan paid its first awards to participants in fiscal year 2001, and in that year the plan paid awards at 2.15 percent of base compensation to 2,217 participants. In the schedule below, we have reported the payment history of the VPP from fiscal year 2001 through fiscal year 2006, including the number of participants, the total payment, average payment per participant, the corresponding EPS achievement for the performance period, and the percentage of a participant's base compensation for determination of the award level.

Variable Pay Plan ("VPP") Payment History

	2001	*2002*	*2003*	*2004*	*2005*	*2006*
Number of participants	2,217	2,108	2,475	2,362	3,846	4,161
Total payment	$1,661,441.00	$1,286,448.00	$1,741,541.74	$2,415,122.12	$3,703,635.58	$4,243,571.32
Average payment per participant	$749.41	$610.27	$703.65	$1,022.49	$962.98	$1,019.84
EPS	$1.56	$1.45	$1.54	$1.63	$1.72	$1.82
Award Percentage	2.15%	1.45%	1.71%	2.38%	2.12%	2.10%

Q. WHAT IS THE MANAGEMENT INCENTIVE PLAN?

A. The Management Incentive Plan, or "MIP", is an extension of the VPP and is limited to a select group of management employees who are responsible for directing and overseeing the day-to-day operations of the Company. In fiscal year 2006, 127 Company officers and other senior managers and directors participated in the plan and received awards. The MIP provides the management team with the opportunity to earn a cash-based incentive award based upon the Company's return on equity performance which is expressed to participants as an EPS target.

Q. WHAT AWARD OPPORTUNITIES ARE AVAILABLE TO PARTICIPANTS UNDER THE MIP?

A. Participants in the plan receive a target award opportunity each year expressed as a percentage of base compensation. The target award opportunities vary by salary grade, and the opportunities increase with corresponding higher salary grades as management responsibility increases. These target award opportunity percentages are directly tied to the 50th percentile of competitive market survey data for positions of comparable responsibility for energy services companies of similar size. The size of target awards range from 20 percent of base compensation at target for salary grade 7 up to a target opportunity of 80 percent of base compensation for the CEO position. In addition to a target incentive opportunity, there are threshold and maximum levels of payment opportunity based upon a predetermined set of performance outcomes. For the threshold level of performance, a participant would receive 50 percent of his target award opportunity. For attainment of the maximum level of performance, a participant would receive 200 percent of his target award opportunity.

Q. HOW ARE THE APPLICABLE THRESHOLDS FOR AWARDS UNDER THE MIP DETERMINED?

A. The annual performance targets for the MIP are the same performance targets for the VPP, as determined by the return on equity target converted to an EPS target. For example, the MIP performance scale for fiscal year 2006 was essentially the same as that for the VPP, as shown in the table below:

MIP Performance Schedule – 2006 Fiscal Year				
Performance Level	*Annual EPS*	*ROE*	*Basis for Performance Target*	*Payout as Percent of Participant's Target Opportunity*
Threshold	$1.59	8.00%	100 basis points below budget ROE	50%
Target	$1.80	9.00%	2006 Budget	100%
Maximum	$2.01	10.0%	100 basis points above budget ROE	200%

Q. CAN MIP PARTICIPANTS INFLUENCE EPS RESULTS?

A. Yes. As with the VPP, the MIP pays awards only when the Company reaches or exceeds desired levels of profitability as measured by both return on equity and earnings per share. Participants in the MIP are cognizant of the EPS targets and manage for the same performance metrics that influence EPS results as with the VPP: managing unnecessary costs, being attentive to customer service levels, minimizing safety incidents, and enhancing employee productivity.

Q. HAS THE COMPANY HISTORICALLY MADE AWARDS PURSUANT TO THE MIP TO PLAN PARTICIPANTS?

A. The MIP was implemented at the same time that the VPP plan was implemented in fiscal year 1999 and has been an integral part of the Total Rewards program. The plan did not pay incentive awards in either fiscal year 1999 or fiscal year 2000 since the Company did not achieve its threshold level of EPS performance. Since fiscal year 2001, the plan has provided payments as follows to its participants:

Management Incentive Plan ("MIP") Payment History						
	2001	*2002*	*2003*	*2004*	*2005*	*2006*
Number of participants	83	85	93	92	99	127
Total payments	$1,839,175.00	$1,824,300.00	$2,195,100.00	$3,805,400.00	$3,318,300.00	$6,244,400.00
Average payment per participant	$22,159	$21,462	$23,603	$41,363	$33,518	$49,169
EPS	$1.56	$1.45	$1.54	$1.63	$1.72	$1.82

Q. WHAT IS THE LONG TERM INCENTIVE PLAN FOR MANAGEMENT?

A. The Long Term Incentive Plan for Management, or "LTIP", is an equity-based incentive program which focuses upon the long-term strength and financial viability of the Company. Since 2003, the LTIP has provided long-term incentives to its management team in two forms: (1) time-lapse restricted shares; and (2) performance-based restricted share units. Long-term incentives are granted annually to participants and are based upon competitive long-term expected values awarded at the 50th percentile of competitive market practice. The long-term awards are allocated by taking 50 percent of the total award opportunity and granting that portion in time-lapse restricted shares, and taking the remaining 50 percent of the total award opportunity and granting that portion in performance-based restricted shares.

Q. PLEASE EXPLAIN THE TWO FORMS OF LTIP AWARDS IN MORE DETAIL.

A. The time-lapse restricted shares are subject to a three-year restricted period. The shares are paid to the participant free of restrictions following the three-year service period from the date of grant. During the restricted period, the dividends on the time-lapse restricted shares are paid at the same rate as such dividends are declared for all of the Company's common shares.

The performance-based restricted share units must be earned over a three-year performance period. The performance measure for determination of the number of units earned is the Company's cumulative three-year earnings per share (EPS) compared to the planned or targeted level of EPS for the same period. If the Company achieves 100 percent of the EPS three-year target, the participant will receive 100 percent of the performance share units granted. If the Company achieves only the threshold level of three-year EPS performance, the participant will receive 50 percent of the performance share units granted. If the Company achieves the maximum level of three-year EPS performance, the participant will receive 150 percent of the performance share units granted. Dividends on the performance-based restricted share units are credited to the participant's account with the payment of such dividends not occurring until the three-year cumulative earnings per share performance targets are measured at the end of the three-year performance measurement cycle.

Q. WHAT IS THE PURPOSE OF THE THREE-YEAR PERIOD ATTACHED TO THE TWO FORMS OF LTIP AWARDS?

A. The purpose of the long-term performance incentive is to focus management's attention upon the long-term sustained results through superior earnings performance. As with the annual incentive plan, superior earnings performance comes from actions like managing excessive and unnecessary costs, driving performance through enhanced productivity, eliminating accidents and safety incidents, and managing customer service levels. These actions are the focus of an extended time period of three years with respect to long-term incentives.

Q. IS THE LTIP A NECESSARY PART OF THE COMPANY'S COMPENSATION PACKAGE OFFERED TO ITS SENIOR MANAGERIAL AND EXECUTIVE EMPLOYEES?

A. Yes. Atmos, like its competitor companies, must provide attractive long-term incentive opportunities to its senior management team in order to attract qualified individuals to the Company. Equity incentives like restricted stock and restricted share units also provide the Company with a retention vehicle to ensure that the organization retains the management talent required to lead and operate a Company of the size and stature of Atmos. Atmos would be at a distinct competitive disadvantage were it not able to provide competitive long-term equity incentive opportunities to its management team.

Q. AS A REFERENCE POINT, CAN YOU EXPLAIN THE COMPANY'S OVERALL COMPENSATION PHILOSOPHY?

A. The Company aims to provide its executives and all employees with a fair, equitable and competitive total rewards program. The program is designed to help the Company attract and retain quality employees by targeting pay at the median (50^{th} percentile) of the competitive market in which the Company competes for talent. The competitive market, for purposes of the incentive programs described above, are defined as companies in the energy industry. The program is carefully monitored and managed to ensure that it fairly serves all of its stakeholders – employees, customers, and shareholders.

Q. HOW DOES INCENTIVE COMPENSATION FIT INTO THE COMPANY'S COMPENSATION PHILOSOPHY?

A. The Company's compensation program is comprised of many components. One integral component is the use of variable incentive compensation plans for both management and non-management employees. Atmos' variable incentive compensation plans and the philosophy behind those plans contain a number of advantages. First, incentive compensation is a variable cost (as opposed to the fixed cost element of base salary) and the variable element of pay is awarded only when the Company can justify and afford to make such payments based upon financial performance. This is the underlying tenet of the Company's pay for performance philosophy.

Incentive pay also improves the Company's ability to recruit and retain talented employees since incentive compensation is widely prevalent in the labor markets in which the Company competes for key talent. Incentive compensation is viewed as pay at risk and motivates employees to achieve important performance goals in order to earn additional financial rewards. In this regard, incentive compensation is not an entitlement but instead represents the Company's willingness to pay for performance which exceeds reasonable expectations.

Properly designed incentive plans also encourage teamwork and the achievement of common purpose by helping employees become more engaged in their jobs, thereby benefiting customers, shareholders, other employees and the communities served by the Company.

Finally, incentive plans improve company communications about performance goals and other performance matters instrumental to the Company's success.

III. BENEFITS OF INCENTIVE COMPENSATION

Q. DO RATEPAYERS BENEFIT FROM THE COMPANY'S USE OF VARIABLE INCENTIVE COMPENSATION PLANS?

A. Yes. Until the 1990's, utilities were reluctant to adopt variable incentive compensation plans as a part of their overall pay strategy. Due to the many regulations imposed upon utilities by various authorities, it was commonly believed that variable pay incentive plans were an inappropriate form of compensation since shareholder and ratepayer interests could not be properly balanced. Therefore, it was easy for utilities to pay and justify high base salaries (as compared to other industries) and to add generous and expensive employee benefit plans in order to compete with other large employers.

The Company could easily follow this traditional path and could eliminate variable incentive compensation from its rewards program. In turn, Atmos would have to dramatically increase base salaries and employee benefit levels in order to provide a competitive rewards package in terms of total value. This would result in higher fixed costs, which would be directly borne by the ratepayers. Wisely, the Company's pay philosophy incorporates the use of incentive compensation for all employees because of the many advantages that such variable compensation provides to all stakeholders of the Company.

Q. ARE VARIABLE INCENTIVE COMPENSATION PLANS USED WIDELY IN THE UTILITY INDUSTRY TODAY?

A. Yes. Virtually all investor-owned gas and electric utilities have moved in the direction of incentive compensation as an integral component of their compensation plans. Annual incentive plans for both management and non-management employees have become particularly prevalent throughout the gas utility industry, clearly illustrating the requirement for offering competitive compensation opportunities throughout the organization.

Q. HAVE THERE BEEN ANY RECENT STUDIES WHICH SUPPORT YOUR CONCLUSION?

A. In 2005, the American Gas Association (AGA) undertook a major survey of competitive compensation practices in the gas utility industry. Sixty-one (61) companies participated in the survey, which was conducted by Effective Compensation, Inc. I have included several highlights from the AGA survey which clearly indicate the prominence of incentive compensation plans in U.S. gas utilities.

In Table 1 below, I have reported the percentage of companies reporting the use of incentive plans for either hourly, salaried, professional, supervisory, managerial or executive employees. The AGA survey indicates that 90% of the surveyed companies have one or more types of incentive plans. Such companies also indicate their ratings of success for their incentive plans.

Table 1 – Variable Plan Usage/Success by Revenue Category

Firm Revenue	% Have	% Consider	% of Firms With Plans That Include These Employees: Hourly	Salary	Prof.	Supv.	Mgmt.	Exec.	Success* Average Rating
All	90%	2%	65%	60%	95%	96%	98%	98%	2.1
<$350M	73%	0%	64%	64%	91%	100%	100%	91%	2.2
$350M – $1.5B	88%	6%	43%	43%	93%	93%	100%	100%	1.9
>$1.5B	100%	0%	67%	67%	97%	97%	97%	100%	2.1

* 1 = Very Successful 2 = Successful 3 = Limited Success 4 = Not Successful
Source: 2005 American Gas Association

Table 2 below includes competitive data regarding the type of incentive plans deployed by gas utilities. As noted, 85% of the surveyed companies have an organization-wide incentive plan, and that these types of plans go deep into their respective organizations. Of importance is the survey finding that 64% of the hourly employees, 57% of the salaried employees and 89% of the professional employees in those companies having organization-wide incentive plans participate in such plans. These plans are also rated as successful by the organizations having such plans.

Table 2 – Variable Compensation Programs – Usage and Success by Plan Type

Plan Type	% Have	% Consider	% of Firms With Plans That Include These Employees: Hourly	Salary	Prof.	Supv.	Mgmt.	Exec.	Success* Average Rating
Org-Wide Incentive	85%	0%	64%	57%	89%	89%	96%	95%	2.0
Small Group Incentive	24%	2%	46%	31%	92%	85%	85%	50%	2.0
Individual Incentive	55%	0%	50%	33%	88%	83%	93%	76%	2.1
Spot Bonuses	42%	0%	70%	61%	91%	91%	91%	48%	2.2

* 1 = Very Successful 2 = Successful 3 = Limited Success 4 = Not Successful
Source: 2005 American Gas Association

Finally, as illustrated in Table 3 below, the AGA survey also cites the types of performance measures found in incentive plans. As noted, the survey findings indicate that a balance of measures are used including financial as the most prevalent, customer satisfaction as the second most prevalent, and safety as the third most prevalent.

Table 3 – Payout Measures

Measure	All	Small	Medium	Large
Financial	98%	100%	93%	100%
Productivity	65%	50%	57%	71%
Quality	46%	50%	50%	43%
Safety	65%	67%	57%	68%
Cost Reduction	54%	67%	50%	54%
Attendance	4%	17%	0%	4%
Project Milestone	46%	67%	36%	46%
Output/Volume	19%	33%	14%	18%
Customer Satisfaction	83%	67%	93%	82%

Source: 2005 American Gas Association

Q. EVEN THOUGH INCENTIVE COMPENSATION PLANS ARE WIDELY USED IN THE GAS UTILITY INDUSTRY, HAVE YOU FOUND THAT THERE REMAINS RESISTANCE TO INCLUSION OF THESE COSTS IN RATES?

A. Yes. The common argument advocated by opponents is that incentive compensation that is tied to financial performance indicators, such as earnings per share or return on invested capital, is a cost that should be borne by a company's shareholders and not the ratepayers. This reasoning is based upon the erroneous assumption that such plans are designed solely to increase profit for shareholders to the exclusion of more customer-oriented aims such as controlling costs and providing superior customer service. This faulty assumption leads to the misconception that incentive plans only promote results whereby the utility's shareholders and employees reap all of the financial rewards of higher earnings to the detriment of ratepayers.

However, earnings are derived by not only increasing revenues, but also by minimizing expenses. To the extent that Company management can minimize unnecessary costs, reduce the number of accidents and safety incidents, deliver satisfactory customer service with reasonable expense and staff levels, and improve performance by increasing productivity, the Company's bottom line (i.e., earnings or earnings per share) will be increased and benefit all constituents.

Q. ARE THE COMPANY'S EMPLOYEES THE PRINCIPAL BENEFICIARIES OF INCENTIVE COMPENSATION PLANS THAT

HAVE NO UNDERLYING OBJECTIVE OF CONTROLLING COSTS OR EXPENSES?

A. Nothing could be further from the truth. The Company's incentive compensation plans are funded based upon the key financial metric of earnings per share (EPS). This metric considers both revenues and expenses in the determination of earnings levels and performance of the Company. Maximization of EPS requires the achievement of rate-based allowed revenues while at the same time controlling expense levels. The attainment of EPS is to the benefit of both shareholders and ratepayers, not one group exclusively. Therefore, both ratepayers and shareholders should recognize the full costs of incentive compensation since it is to the mutual benefit of both constituents.

Q. DO THE COMPANY'S INCENTIVE COMPENSATION PLANS ONLY PROMOTE HIGHER EARNINGS THAT DO NOT BENEFIT RATEPAYERS?

A. This is a common misconception by opponents of incentive compensation and fails to consider that important customer-based considerations are key components of EPS. EPS is the Company's net income divided by total shares outstanding and is considered to be a company's quantity of earnings. Net income is enhanced by both maximizing revenues and controlling expenses. Therefore, higher productivity, more careful management of operations and maintenance costs, and other customer-oriented goals improve net income. As a result, EPS is an important benchmark of the benefit provided to both customers and shareholders.

In my experience and that of my firm, we have found that variable incentive compensation plans benefit all stakeholders – customers, shareholders, employees and the communities served by the Company. It is a variable expense and is tied to improvements in productivity, service, cost management, and other performance factors that drive EPS. Variable incentive compensation plans provide the management of the utility the flexibility to motivate, recognize, and reward performance of their employees. These plans are an allowable part of payroll expenses and should be recovered in a utility's cost of service, especially when such plans create a financial incentive for employees to achieve goals that are important to customers.

Q. WOULD THE DISALLOWANCE OF INCENTIVE COMPENSATION COSTS AS PART OF THE COMPANY'S RATES PLACE IT AT A COMPETITIVE DISADVANTAGE?

A. Yes. It is commonly understood that regulation is superimposed upon utilities such as the Company as a substitute for competition, but not to eliminate competition. In the context of recruiting and retaining valued employees, the Company faces competition not only from its own industry but also from other industries that are not regulated utilities. Those industries that are not regulated utilities are free to factor the cost of incentive compensation into the price of the products or services they sell. If the Company is not permitted to do so, then it is placed at a competitive disadvantage. Any rate that doesn't represent the amount of expense that a utility must incur to be competitive in the employment market does not meet the goal of fair and effective regulation.

Q. HAVE YOU COMPARED THE COMPENSATION LEVELS OF ATMOS TO OTHER COMPANIES FOR WHICH ATMOS COMPETES FOR TALENT?

A. Yes. When employee salaries and total cash compensation levels are compared to other similar positions in the applicable markets, we find that on average, the Company is paying at the 50th percentile in the market, including both base and variable incentive pay. Towers Perrin periodically conducts an analysis of the competitive levels of selected benchmark positions to determine whether the compensation offered by the Company remains competitive.

Q. WHY IS THIS IMPORTANT?

A. As stated above, the Company's total compensation, including both base and variable incentive pay, positions its employees at the 50th percentile for the market. If the regulatory authority were to disallow any or all of the variable incentive pay component from recovery in rates, then the Company's employee compensation costs reflected in the cost of service would be below the average for the market and would result in levels in the cost of service that are not reasonable when compared to that market.

Q. Does this conclude your testimony?

A. Yes.

BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

IN RE:	)	
	)	
PETITION OF ATMOS ENERGY	)	
CORPORATION FOR APPROVAL OF	)	
ADJUSTMENT OF ITS RATES AND	)	
REVISED TARIFF	)	**DOCKET NO. 07-_______**

VERIFICATION

STATE OF TEXAS)
)
COUNTY OF DALLAS)

I, John R. Ellerman, being first duly sworn, state that I am a Managing Principal with the consulting firm of Towers Perrin, that I am authorized to testify on behalf of Atmos Energy Corporation in the above referenced docket, that the Testimony of John R. Ellerman in support of Atmos Energy Corporation's Petition thereto pre-filed in this docket on the date of filing of this Petition are true and correct to the best of my knowledge, information and belief.

John R. Ellerman

Sworn and subscribed before me this 11 day of April, 2007.

MARLENE A. IREY
Notary Public, State of Texas
My Commission Expires
August 29, 2009

Marlene Irey
Notary Public

My Commission Expires: August 29, 2009