BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

IN RE:

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

PRE-FILED TESTIMONY OF GARY L. SMITH
ON BEHALF OF ATMOS ENERGY CORPORATION

I. NAME AND POSITION

Q. PLEASE INTRODUCE YOURSELF.

A. My name is Gary L. Smith. I am Vice President – Marketing and Regulatory Affairs for Atmos Energy Corporation's (sometimes referred to as the "Company") Kentucky/Mid-States operations. My business address is 2401 New Hartford Road, Owensboro, Kentucky 42303.

II. SUMMARY OF TESTIMONY

Q. WHAT SUBJECTS ARE COVERED BY YOUR DIRECT TESTIMONY IN THIS CASE?

A. My testimony supports the Company's proposal to incorporate a Customer Utilization Adjustment (CUA). The CUA will complement the Company's Weather Normalization Adjustment (WNA) rider. It is designed to compensate for customer volume variances associated with factors other than weather.

Q. DID THE COMPANY MAKE A SIMILAR PROPOSAL DURING DOCKET NO. 05-00258?

A. Yes. Ms. Patricia Childers presented testimony on a CUA in that case. However, the Company has revised its proposal. Atmos Energy's proposal in this case is

similar to what was proposed to the Tennessee Regulatory Authority (TRA) recently by Chattanooga Gas Company.

Q. ARE YOU SPONSORING ANY OF THE MINIMUM FILING REQUIREMENTS IN THIS CASE?

A. No, I am not sponsoring any of the minimum filing requirements in this docket.

III. BACKGROUND AND QUALIFICATIONS OF WITNESS

Q. PLEASE DESCRIBE YOUR CURRENT RESPONSIBILITIES, AND PROFESSIONAL AND EDUCATIONAL BACKGROUND.

A. I am responsible for rates and regulatory affairs, as well as directing the marketing plans and strategies for natural gas utility services to residential, commercial, and industrial sales and transportation markets in the Kentucky/Mid-States division. I am a 1983 graduate of the University of Kentucky, with a Bachelor of Science degree in Civil Engineering. I have worked for Atmos Energy Corporation or its predecessor, Western Kentucky Gas Company, since 1984, initially as Project Engineer. After serving in a variety of technical and supervisory engineering positions, I transferred into the Industrial Marketing department in 1990. I became Director of Large Volume Sales in 1991, was named Vice President – Marketing in 1998, and named to my current position in 2003. I also serve on numerous corporate-wide committees, including chair of Atmos Energy's Utility Marketing Council, a group responsible for corporate-wide market development policies. I am active in civic and community organizations and associations relating to the natural gas industry. I am immediate past-chairman of the Utilization Technology Development, NFP Corporation and previously served as chair of the Strategic Marketing Committee for the American Gas Association (AGA).

Q. HAVE YOU EVER SUBMITTED TESTIMONY BEFORE THE TENNESSEE REGULATORY AUTHORITY?

A. Yes. In 2006, I served as witness rebutting an intervention group's proposal for a transportation customer storage service in TRA Docket No. 05-00258.

Q. HAVE YOU TESTIFIED ON MATTERS BEFORE OTHER STATE REGULATORY COMMISSIONS?

A. Yes, before the Kentucky Public Service Commission (KPSC), the Georgia Public Service Commission (GPSC), and the Missouri Public Service Commission (MPSC).

IV. REVIEW OF CUSTOMER VOLUME VARIANCES AND THEIR EFFECT ON COMPANY REVENUES

Q. PLEASE EXPLAIN THE IMPACT OF CUSTOMER VOLUME CHANGES ON ATMOS ENERGY'S FINANCIAL PERFORMANCE.

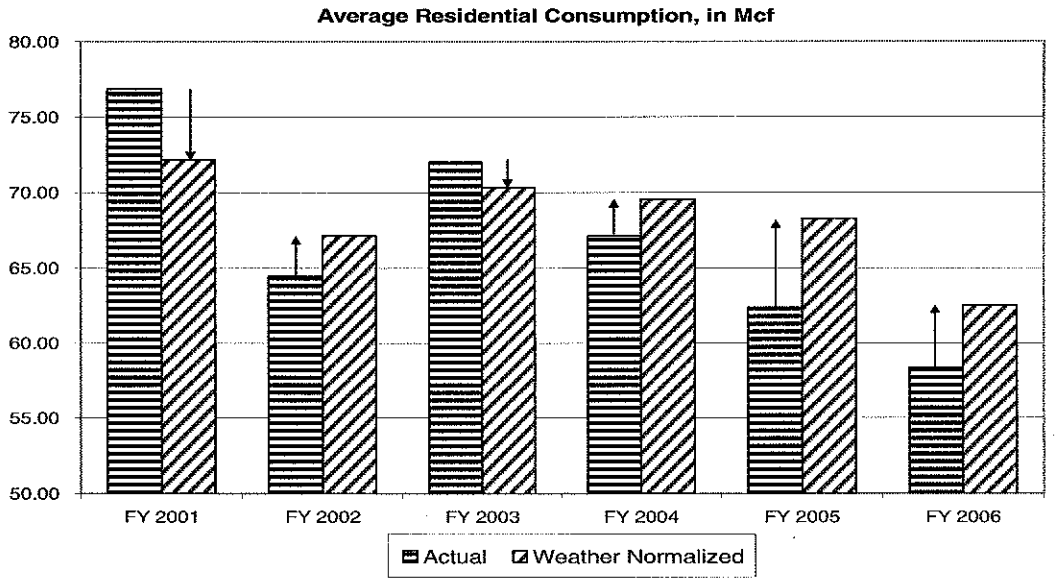
A. Under traditional rate design, a utility's authorized revenue requirement, exclusive of gas costs, is divided between a fixed monthly customer charge component and a volumetric rate component charged per unit of gas sold or transported. The volumetric charge is calculated based upon the level of sales or transportation volumes at normal weather conditions for the annual period. The vast majority of non-gas costs borne by a utility, and correspondingly its revenue requirements, are fixed, and are basically unaffected by the volumes sold or transported. Thus, as annual volumes drop below the weather-normalized rate case volumes upon which the revenue requirements were based, the utility under-recovers its authorized non-gas revenues. Alternatively, higher annual volumes lead to recovery of non-gas revenues above the established revenue requirement.

Q. WHAT FACTORS CAUSE VARIATIONS IN CUSTOMER USAGE PATTERNS FROM THE CONSUMPTION BASIS USED IN DETERMINING RATES?

A. Weather is the factor typically having the greatest influence on customer usage variations from the assumptions utilized in deriving volumetric distribution rates. Many customers, particularly in the residential and commercial classes, use natural gas for space heating. For most residential customers and for many commercial customers, the majority of their annual gas consumption is used for

space heating. Since volumetric rates are set in a comprehensive rate case based upon "normal" outdoor temperatures, if weather is warmer than normal, customer usage will be lower than the volumes assumed in setting the rates. Alternatively, if weather is colder than normal, customer usage will be greater than the volumes assumed in setting the rates. WNA mechanisms address the volume variances caused by weather. Chart GLS-1 shows the variability in actual residential volumes in Tennessee from year to year, and also shows the adjusted volumes that would have occurred if weather had been normal.

Chart GLS-1



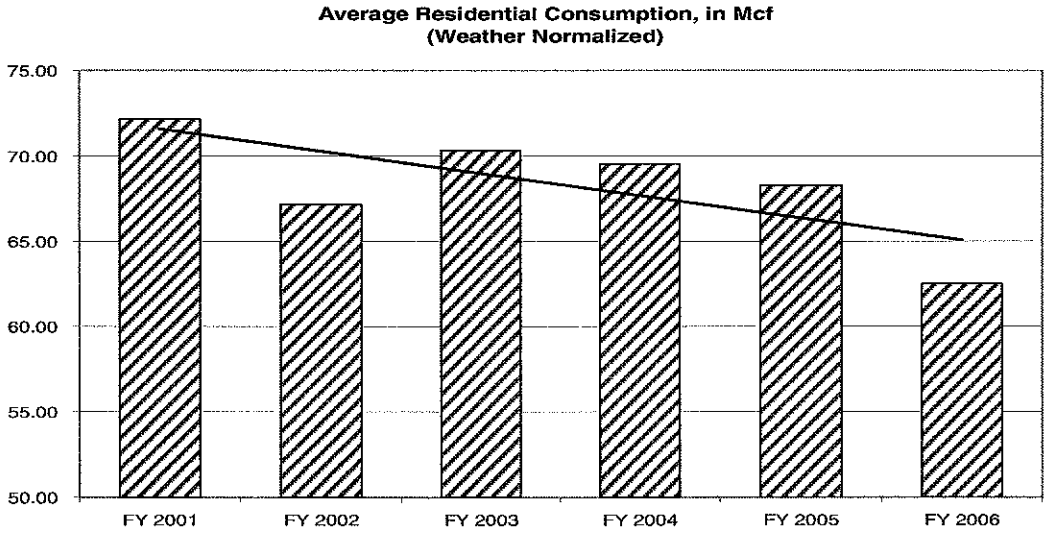
The WNA mechanism is designed to adjust the Company's non-gas revenues to compensate for the volume variances associated with abnormal weather, represented as arrows in the preceding chart. The benefit of a WNA is that neither the customer nor the Company bears an advantage or disadvantage as a result of abnormal weather during any heating season.

Q. ARE THERE FACTORS OTHER THAN WEATHER THAT INFLUENCE CUSTOMER CONSUMPTION?

A. Yes. Although weather is the primary driver, other factors, such as improved efficiency and conservation also influence gas consumption over time. The gas industry as a whole is faced with declining usage per customer, and Atmos

Energy's Tennessee service area is no exception. Chart GLS-2 graphs the weather-normalized consumption for Atmos Energy's residential customers in Tennessee, and a trendline for the period.

Chart GLS-2



A 2004 study conducted by the American Gas Association (AGA) concluded that, removing the effects of weather, natural gas usage per household, which has dropped by over 20% since 1980, will continue to decline over the next several years. This decline is due in large part to conservation measures, including progressive increases in the energy-efficiency of appliances and more efficient new homes. In addition, utilities have seen consumers heighten their conservation efforts in response to higher pass-through gas supply prices in recent years.

Q. HOW DO THESE CONSUMPTION PATTERNS IMPACT ATMOS ENERGY'S NON-GAS REVENUES?

A. While the WNA rider has neutralized the impact of weather on the Company's ability to recover its authorized revenue requirements, the Company remains fully exposed to changes in customer usage patterns beyond those associated with weather. In today's environment of higher natural gas supply prices, Atmos Energy wishes to align its interests with those of its customers in regard to efficient energy use. Unfortunately, traditional and current rate designs encourage

the promotion of increased gas consumption, as the way for a gas company to recover its fixed costs and its authorized revenue requirements.

V. WNA RIDER AND PROPOSED CUA RIDER

Q. IS ATMOS ENERGY PROPOSING ANY MODIFICATIONS TO THE EXISTING WNA RIDER?

A. The Company does not propose any changes to the WNA mechanism, other than updating the base load and heating sensitive load factors used in the calculation. Company witness James Cagle is addressing these updates in his testimony.

In 1991, in Docket No. 91-01712, the Tennessee Public Service Commission (now the TRA) adopted the WNA rider for the state's three regulated gas utilities, United Cities Gas Company (now Atmos Energy), Chattanooga Gas Company, and Nashville Gas (now Piedmont Natural Gas). The WNA Rider achieves its purpose by protecting both the consumer and the company from fluctuations in gas consumption caused by weather that is colder or warmer than normal. However, as I discussed above, even with the WNA, the Company's collection of non-gas revenues remains linked to volumes of gas sold.

Q. PLEASE DESCRIBE THE PURPOSE OF THE PROPOSED CUSTOMER UTILIZATION ADJUSTMENT.

A. The proposed CUA would further "decouple," or break the link between, the Company's revenue and the quantity of gas consumed by its customers. As noted previously, the Company's cost of service is recovered through both monthly and volumetric charges. However, excluding the cost of commodity gas supply, very few gas utility costs are variable and thus driven by changes in volume. Therefore, the Company's cost of service, while almost exclusively fixed in nature, is dependent on sustained volume levels to afford recovery of authorized revenues. As shown previously in Chart GLS-2, weather-normalized volumes consumed by the Company's customers have been declining and will continue to do so. The CUA would address these non-weather- related volume changes.

Atmos Energy's CUA, as set forth on the Company's proposed Original Tariff Sheet No. 51.1, would, annually, compare the actual non-gas revenues per customer for each applicable rate schedule, including the WNA revenue, to those established in this docket. The resulting difference within each class then would be multiplied by the actual number of customers, to determine the excess revenue to be refunded to, or the revenue deficiency to be collected from, each class. The excess or deficiency then would be divided by the annual projected volume for each class, to determine the CUA charge or credit rate.

Q. WILL THE CUA BE "TRUED UP"?

A. Yes. The calculation would include a cumulative annual "true up" to ensure that the Company does not over- or under-collect from the ratepayer. The true up will work similar to the ACA (actual cost adjustment) of the PGA (purchased gas adjustment).

Q. WILL THE APPROVAL OF THE CUA GUARANTEE THAT ATMOS ENERGY WILL ALWAYS EARN ITS ALLOWED RATE OF RETURN?

A. No. As previously stated, the CUA, like the WNA Rider, merely ensures that the Company's ability to recover the costs approved in this docket is not held hostage to fluctuations in gas consumption, which are beyond the Company's control. The Company is still responsible for controlling its costs, and remains subject to the overall risks and uncertainties associated with doing business. The proposed CUA only compensates the Company for lost non-gas revenues the Company has been authorized to recover by this Authority, and its approval will simply provide the Company with a reasonable opportunity to recover its TRA-authorized non-gas revenues.

Q. WHAT ARE THE LARGER POLICY IMPLICATIONS OF DECOUPLING?

A. The practice of allowing gas utilities to recover fixed costs through the use of volumetric rates was initiated years ago with the underlying objective of motivating gas utilities to sign up new customers and increase gas sales. Since the dramatic rise of natural gas prices in 2000-2001, public policy has shifted away from promoting increased gas consumption. Instead, policymakers have

stressed the importance of encouraging conservation in order to reduce overall demand, and place downward pressure on skyrocketing gas prices.

One industry analyst described volumetric rate design as an obsolete anomaly in light of recent changes in public policy towards conservation:

> As the fixed charges appear year in and year out regardless of gas usage, the volumetric approach to cost recovery for operating a gas distribution system is a faulty equation which needs to be rectified in ratemaking. It would appear therefore, that unless and until this anomaly is corrected, the LDC [Local gas Distribution Company] would lack the necessary tools with which to earn its allowed rate of return.[1]

To the extent that conservation efforts affect volumes sold, and correspondingly, the Company's non-gas commodity revenue recovery, the current rate design has the unintended consequence of pitting the Company's financial performance against conservation efforts. The proposed CUA will decouple the collection of non-gas revenues from the volumes of gas consumed, and thus remove the current disincentive to encourage energy efficiency and conservation.

Q. WHAT EVIDENCE EXISTS TO SUPPORT THIS SHIFT IN POLICY TOWARDS CONSERVATION AND AWAY FROM RATE DESIGNS THAT ENCOURAGE INCREASED GAS SALES?

A. Numerous policy groups and government bodies have issued public statements on the issue. The following list, while certainly not exhaustive, outlines the most recent examples of such public policy statements:

- In July 2004, the AGA and the Natural Resources Defense Council ("NRDC") issued a joint statement encouraging state commissions to consider mechanisms to decouple the link between volumes sold and revenues: "NRDC and AGA agree on the importance of state Public Utility Commissions' consideration of innovative programs that encourage total energy efficiency and conservation in ways that align the interests of state regulators, natural gas utility company customers, utility

[1] J Moody's Investors Service Special Comment *Local Gas Distribution Companies: Update on Revenue Decoupling and Implications for Credit Ratings*, p. 4 (June 2006).

shareholders, and other stakeholders." A copy of the Joint Statement is attached as Exhibit GLS 1. It expressly recognizes the link between conservation and controlling the rising costs of natural gas, and notes that if companies, commissions and consumers work together to make natural gas consumption more efficient, particularly on peak days, and reduce overall demand, many experts believe we can put more downward pressure on natural gas prices and decrease price volatility. The Joint Statement acknowledges that decoupling mechanisms could have significant widespread benefits, including:

- Customers could save money by using less natural gas;
- Reduced overall use will help to push down short-term natural gas prices at times when markets are under stress, thereby reducing costs for all customers (whether or not they participate in the utility program);
- Utilities would recover their costs and have a fair opportunity to earn their allowed return;
- State policies to encourage economic development could be enhanced by increased energy efficiency and lower business energy costs;
- State PUCs [Public Utility Commissions] would be able to support larger state policy objectives as well as programs that reflect the public's desire to use energy efficiently and wisely.

The Joint Statement concludes that in "today's climate of rapidly changing natural gas prices, such reforms make good sense for consumers, shareholders, state governments, and the environment."

- Also in July 2004, prompted by the concerns cited in the Joint Statement, the National Association of Regulatory Utility Commissioners ("NARUC") issued a resolution encouraging regulators to approve decoupling mechanisms for the utilities they regulate. A copy of the resolution is attached as Exhibit GLS-2. The 2004 NARUC Resolution states, in relevant part:

"WHEREAS, the Natural Resources Defense Council (NRDC), the American Gas Association (AGA) and the American Council for an Energy Efficient Economy (ACEEE) have urged public utility commissions to align the interests of consumers, utility shareholders, and society as a whole by encouraging conservation. Among the mechanisms supported by these groups are the use of automatic rate true-ups ***to ensure that a utility's opportunity to recover authorized fixed costs is not held hostage to fluctuations in retail gas sales.***" (emphasis added)

- In November 2005, NARUC issued a second resolution, which, citing record high gas prices and damage suffered from Hurricanes Katrina and Rita, again encouraged state commissions to "implement innovative rate designs that will encourage energy conservation and energy efficiency that will assist in moderating natural gas demand and reducing upward pressure on natural gas prices." A copy of the 2005 NARUC Resolution is attached as Exhibit GLS-3.
- Congress has weighed in on decoupling. The Energy Policy Act of 2005 requires the U.S. Department of Energy, in consultation with NARUC and the National Association of State Energy Officials, to conduct a study of state and regional policies to promote energy conservation. Under the Act, those policies should consider methods of removing disincentives for gas and electric utilities to implement energy efficient programs.
- Also at the national level, the U.S. Environmental Protection Agency's recently initiated Clean Energy Policy Initiative will review decoupling in terms of evaluating ways to remove disincentives for natural gas and electric utilities to promote energy efficiency.

Q. HAVE OTHER STATES ADOPTED MECHANISMS TO DECOUPLE REVENUES FROM VOLUMES?

A. Yes. In a recent Special Comment on decoupling, Moody's Investors Service concluded that "[w]hile RD [revenue decoupling] may have originally begun as a regional concept in certain jurisdictions, it has quickly become a nationwide

phenomenon that will challenge regulators and gas utilities alike, as they seek to correct a structural imbalance in their rate design that has become increasingly difficult to ignore."[2] In addition to WNA mechanisms, which have been in use since the 1980s, several states have approved decoupling mechanisms for gas utilities. Pacific Gas and Electric in California was the first gas utility to adopt a form of a decoupling mechanism, starting in 1978. As of March 2007, 10 state commissions have approved decoupling mechanisms for 18 gas utilities, including:

- Pacific Gas & Electric, San Diego Gas & Electric, Southern California Gas and Southwest Gas in California,
- Vectren in Indiana,
- Baltimore Gas & Electric and Washington Gas in Maryland,
- Atmos Energy and Missouri Gas Energy in Missouri,
- New Jersey Natural Gas and South Jersey Gas in New Jersey,
- Vectren in Ohio,
- Northwest Natural Gas and Cascade Natural Gas in Oregon,
- Piedmont Natural Gas in North Carolina,
- Questar Natural Gas in Utah, and
- Avista Corporation and Cascade in Washington.

Additionally, at least 12 gas utilities have filed decoupling proposals. Proposals include:

- CenterPoint Energy (Arkansas)
- UNS Gas (Arizona)
- PSC of Colorado (Colorado)
- Peoples Gas / Integrys (Illinois)
- CMS Energy (Michigan)
- Excel Energy (Minnesota)
- Public Service Company of New Mexico (New Mexico)

[2] Moody's Investors Service Special Comment *Local Gas Distribution Companies: Update on Revenue Decoupling and Implications for Credit Ratings*, p. 6 (June 2006).

- National Fuel Gas Distribution (New York)
- Chattanooga Gas (Tennessee)
- Washington Gas (Virginia and Washington, DC)

Many of the decoupling proposals have met with support from regulators. The decoupling proposal by Questar Gas has received the support of the Utah Division of Public Utilities, and Consumers' Counsel for the State of Ohio has come out publicly in support of decoupling, calling such mechanisms a "win-win" for utilities and consumers. Also, the Iowa Utilities Board has issued a Notice of Inquiry (NOI) in Docket No. NOI-06-01 into the effect of reduced usage on rate regulated gas utilities.

Q. HAVE THE DECOUPLING MECHANISMS THAT HAVE BEEN IMPLEMENTED IN OTHER STATES BEEN SUCCESSFUL IN PRODUCING POSITIVE BENEFITS TO COMPANIES AND CONSUMERS?

A. Yes. Members of the Maryland Public Service Commission Staff have reported that the decoupling mechanism implemented for Baltimore Gas and Electric has fulfilled the regulatory objectives, including: (1) producing more stable revenues by eliminating attrition caused by declining usage; (2) reducing the volatility of gas bills; and (3) providing incentives for conservation, while at the same time remaining easy for the utility to administer and the commission staff to monitor. A 2005 study conducted for Northwest Natural Gas concluded that under its decoupling mechanism: (1) revenues had stabilized; (2) the company had shifted its focus from marketing to promoting energy efficiency; and (3) service quality did not decline.

Q. HOW WOULD THE PROPOSED CUA BENEFIT CUSTOMERS?

A. The CUA would permit the Company to promote conservation without jeopardizing its recovery of authorized revenues. Conservation will benefit consumers, as it will aid in lowering their gas bills. The CUA merely seeks to remedy the current misalignment of interests between shareholders and customers. Rising natural gas market prices in recent years are generally attributed to the strain that growing demand has placed on the nation's gas supply.

While support for increased supplies is a part of the solution, conservation is equally important. In addition, conservation is something each individual can act upon and directly influence in his home or business. Subjecting the Company to traditional rate design does not afford a reasonable opportunity for the Company to achieve its authorized revenue requirements because the fixed costs that we incur are dependent on sustained usage at current levels. Failing to align the interests of the utility service provider with its consumers' efforts to conserve energy, in this price environment, does not promote the best interests of Tennessee ratepayers.

Q. **HAS THE TRA SUPPORTED CONSERVATION?**

A. Yes. As Ms. Childers mentions in her testimony, the TRA has been very proactive in recognizing the importance of energy conservation. A Home Energy Conservation Task Force ("Task Force") has been meeting and reviewing existing state conservation plans and has provided recommendations regarding conservation programs to assist Tennessee utility consumers served by utilities. The Task Force is comprised of a diverse group of individuals representing a cross section of stakeholders with interests in conservation. Among the Task Force members is a representative from each regulated natural gas utility (Atmos Energy, Piedmont Natural Gas and Chattanooga Gas Company) in Tennessee.

Q. PLEASE PROVIDE YOUR UNDERSTANDING OF THE TASK FORCE'S WORK TO DATE.

A. The Task Force has focused on three areas associated with energy conservation. These areas are customer education, diagnostics and remediation. On November 15, 2006, the Task Force submitted its report to the TRA. This report identifies short-term, medium-term and long-term issues and contains eight specific recommendations. Among those recommendations is the implementation of a modest pilot program to allow for learning and evaluation prior to making major implementation commitments. The pilot program includes in-home education after installation of energy saving measures.

Q. IS ATMOS ENERGY ENCOURAGEING ENERGY CONSERVATION IN JURISDICTIONS OTHER THAN TENNESSEE?

A. Yes. Atmos Energy is committed to educating its customers on energy efficiency as well as partnering with other stakeholders to achieve long-term benefits to customers through reducing the demand for energy and thus lowering the cost of energy. The Company's common conservation programs throughout its 12-state utility operations involve educational materials for customers and website energy management tools. Additionally, Atmos Energy supplements these efforts in certain jurisdictions with specific programs to aid energy efficiency improvements and weatherization efforts.

Q. PLEASE DESCRIBE THOSE SUPPLEMENTAL, STATE SPECIFIC EFFORTS.

A. Within the Kentucky/Mid States division, I am very familiar with ongoing programs in both Kentucky and Missouri.

Q. PLEASE DESCRIBE THE PROGRAM IN KENTUCKY.

A. The current demand side management program in Kentucky, ATMOS ENERGY CARES, began in 2000. The program provides supplemental funding for certain weatherization efforts by area community action agencies for low-income customers. The program is managed by a collaborative including Atmos Energy, the Kentucky Association for Community Action, the Attorney General of the Commonwealth of Kentucky, and the Kentucky Legal Aid Society. ATMOS ENERGY CARES annually funds approximately $200,000 toward weatherization programs, with targeted spending for qualifying homes at $1500 per home. The program cost is borne by Atmos Energy's residential customers in Kentucky.

Q. PLEASE DESCRIBE THE MISSOURI PROGRAM.

A. In March of this year, the MPSC approved a decoupled rate design for Atmos Energy, based upon an agreement between Commission Staff and the Company. As part of that agreement, and in an effort to align the interests of the Company with those of its customers, Atmos Energy committed to work collaboratively with the Staff, the Office of Public Counsel and the Department of Natural Resources to develop an Energy Efficiency and Weatherization Program. The program is intended to assist customers in reducing their consumption of natural gas through education, conservation and weatherization. There have been a

number of meetings between the members of the collaborative group over the past two months and the specific parameters of the program are near completion. The program should be implemented late this summer following approval by the MPSC.

The Company has committed to provide annual funding of approximately $165,000 for the program. If approved by the Commission, the program will likely include dollars dedicated to low-income weatherization, rebates for high energy efficiency furnaces and boilers, programmable thermostats, and customer education.

Q. HAS THE COMPANY UNDERTAKEN ANY SPECIFIC EFFORTS TO ENCOURAGE CONSERVATION IN TENNESSEE.

A. The Task Force's first recommendation is the initiation of a workshop specifically to address funding and study decoupling in order to support energy conservation and gas technology/energy conservation. Atmos Energy fully expects that the Task Force will continue its works and implement these recommendations. However, in the meantime, Atmos Energy is spending $50,000 developing an experimental residential weatherization "pilot program" that includes an energy education component. Although still in its formative stages, the Company is hopeful that it can implement the program by mid- to late-summer of this year.

Ideally, funding for such a program would be balanced between customers and shareholders, and be implemented in conjunction with rate designs that no longer penalize the Company financially for customer conservation efforts. However, Atmos Energy is committed to encourage conservation and working toward aligning its interests with those of its customers. We believe this Tennessee pilot program will afford an important learning opportunity for the Company on how to craft an effective weatherization effort. The Company is certainly willing to engage in discussions with the Authority Staff and the Consumer Advocate to develop specific programs to aid energy efficiency improvements and weatherization efforts in light of its CUA proposal to eliminate the long-standing disincentives associated with customer conservation.

Q. DOES THE CUA NEGATE THE BENEFITS OF CONSERVATION MEASURES TAKEN BY CUSTOMERS?

A. No, it does not. A customer's conservation efforts will continue to be rewarded through the avoidance of incremental gas costs. Gas commodity costs constitute the greatest portion of the customer's bill, and with gas supply prices still above historic levels, customers would remain fully motivated to avoid consuming any volume unnecessarily. The Company, which merely passes through the gas costs incurred dollar-for-dollar, would be pleased to fully support the customer's efforts to avoid purchasing an MCF of gas; unfortunately, traditional rate design attaches the largest portion of our authorized revenue requirement to that same MCF conserved. The CUA would realign the interests of customers and shareholders in support of gas conservation.

Q. DO YOU HAVE ANY CONCLUDING REMARKS?

A. Continuation of the WNA, along with approval of the CUA, is good regulatory policy because it is in the best interests of both ratepayers and Atmos Energy. It will benefit ratepayers by adding stability to their annual energy bill. The CUA will benefit Atmos Energy by providing the opportunity to collect the authorized revenue required to recover its costs and earn a fair return, regardless of fluctuations in sales due to weather and conservation efforts. This will afford the Company the ability to continually and consistently make new investments, and provide safe and reliable service year after year at the level of excellence ratepayers have come to expect. For the reasons stated above, and especially in such times of uncertainty in our nation's energy environment, approval of this rider is good regulatory policy, and good for the State of Tennessee.

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes.

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CORPORATION FOR APPROVAL OF	)	
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VERIFICATION

STATE OF KENTUCKY)
)
COUNTY OF DAVIESS)

I, Gary L. Smith, being first duly sworn, state that I am the Vice President-Marketing and Regulatory Affairs for the Kentucky/Mid-States Division of Atmos Energy Corporation, that I am authorized to testify on behalf of Atmos Energy Corporation in the above referenced docket, that the Testimony of Gary L. Smith in support of Atmos Energy Corporation's Petition and the Exhibits 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.

Gary L. Smith

Sworn and subscribed before me this 9th day of April, 2007.

Notary Public - State of KY at Large

My Commission Expires: September 26, 2009

Joint Statement of the American Gas Association and the Natural Resources Defense Council

Submitted to the National Association of Regulatory Utility Commissioners
July 2004

The American Gas Association (AGA) and the Natural Resources Defense Council (NRDC) recognize the many benefits of using clean-burning natural gas efficiently to provide high quality energy services in all sectors of the economy. This statement identifies ways to promote both economic and environmental progress by removing barriers to natural gas distribution companies' investments in urgently needed and cost-effective resources and infrastructure.

NRDC and AGA agree on the importance of state Public Utility Commissions' consideration of innovative programs that encourage increased total energy efficiency and conservation in ways that will align the interests of state regulators, natural gas utility company customers, utility shareholders, and other stakeholders. Cost-effective opportunities abound to improve the efficiency of buildings and equipment in ways that promote the interests of both individual customers and entire utility systems, while improving environmental quality. For example, when energy supply and delivery systems are under stress, even relatively modest reductions in use can yield significant additional cost savings for all customers by relieving strong upward pressures on short-term prices.

NRDC and AGA also encourage state Commissions to support gas distribution company efforts to manage volatility in energy prices and reduce volatility risks for customers.

The Energy Efficiency Problem: Regulated Natural Gas Utilities are Penalized for Aggressively Promoting Energy Efficiency

Local natural gas distribution companies (gas utilities) have very high fixed costs. These fixed costs include the costs of maintaining system safety and reliability throughout the year, staffing customer service telephone lines 24 hours a day and doing what it takes each day of the year to ensure the safe and reliable delivery of natural gas to homes, schools, hospitals, retailers, factories and other customers.

Natural gas utilities typically purchase natural gas on behalf of their customers, and pass through the cost without markup. This means that natural gas utilities do not

profit from their acquisitions of natural gas to serve customer needs. The profit (authorized level of rate of return) comes from the rates utilities charge for transporting the natural gas to customers' homes and businesses.

The vast majority of the non-commodity costs of running a gas distribution utility are fixed and do not vary significantly from month to month. However, traditional utility rates do not reflect this reality. Traditional utility rates are designed to capture most of approved revenue requirements for fixed costs through volumetric retail sales of natural gas, so that a utility can recover these costs fully only if its customers consume a certain minimum amount of natural gas (these amounts are normally calculated in rate cases and generally are based on what customers consumed in the past). Thus, many states' rate structures offer – quite unintentionally – a significant financial disincentive for natural gas utilities to aggressively encourage their customers to use less natural gas, such as by providing financial incentives and education to promote energy-efficiency and conservation techniques.

When customers use less natural gas, utility profitability almost always suffers, because recovery of fixed costs is reduced in proportion to the reduction in sales. Thus, conservation may prevent the utility from recovering its authorized fixed costs and earning its state-allowed rate of return. In this important respect, traditional utility rate practices fail to align the interests of utility shareholders with those of utility customers and society as a whole. This need not be the case. Public utility commissions should consider utility rate proposals and other innovative programs that reward utilities for encouraging conservation and managing customer bills to avoid certain negative impacts associated with colder-than-normal weather. There are a number of ways to do this, and NRDC and AGA join in supporting mechanisms that use modest automatic rate true-ups to ensure that a utility's opportunity to recover authorized fixed costs is not held hostage to fluctuations in retail gas sales.[1] We also support performance-based incentives designed to allow utilities to share in independently verified savings associated with cost-effective energy efficiency programs.

Many states' rate structures also place utilities at risk for variations in customer usage based on variations in weather from a normal pattern. This variation can be both positive and negative. Utilities' allowed rate of return is premised on the

[1]For example, in 2003 the Oregon Public Utility Commission approved a "conservation tariff" for Northwest Natural Gas Company (NW Natural) "to break the link between an energy utility's sales and its profitability, so that the utility can assist its customers with energy efficiency without conflict." The conservation tariff seeks to do that by using modest periodic rate adjustments to "decouple" recovery of the utility's authorized fixed costs from unexpected fluctuations in retail sales. See Oregon PUC Order No. 02-634, *Stipulation Adopting Northwest Natural Gas Company Application for Public Purpose Funding and Distribution Margin Normalization* (Sept. 12, 2003). In California, PG&E and other gas utilities have a long tradition of investment in energy efficiency services, including those targeting low-income households, and the PUC is now considering further expansion of these investments along with the creation of performance-based incentives tied to verified net savings. California also pioneered the use of modest periodic true-ups in rates to break the linkage between utilities' financial health and their retail gas sales, and has now restored this policy in the aftermath of an ill-fated industry restructuring experiment. Thus, in March 2004, Southwest Gas Company received an order that authorizes it to establish a margin tracker that will balance actual margin revenues to authorized levels.

expectation that weather will be normal, on average, and that customer use of gas will maintain a predictable pattern going forward. Proposals by utilities to decouple revenues from both conservation-induced usage changes and variations in weather from normal have sometimes been characterized as attempts to reduce utilities' risk of earning their authorized return. The result of these rate reforms, in this regulatory view, should be a lowered authorized return. But reducing authorized returns would penalize utilities for socially beneficial advocacy and action, including efforts to create mechanisms that minimize the volatility of customer bills.

Our shared objective is to give utilities real incentives to encourage conservation and energy efficiency. With properly designed programs, the benefits could be significant and widespread:

- Customers could save money by using less natural gas;
- Reduced overall use will help push down short-term prices at times when markets are under stress, reducing costs for all customers (whether or not they participate in the utility programs);
- Utilities would recover their costs and have a fair opportunity to earn their allowed return;
- State policies to encourage economic development could be enhanced by increased energy efficiency and lower business energy costs;
- State PUCs would be able to support larger state policy objectives as well as programs that reflect the public's desire to use energy efficiently and wisely.

In today's climate of rapidly changing natural gas prices, such reforms make good sense for consumers, shareholders, state governments, and the environment.

Natural Gas Consumers, Price Volatility and Resource Portfolio Management.

Another area of concern shared by NRDC and AGA is the impact of natural gas price volatility on natural gas consumers, which can be exacerbated by limited diversification of utilities' resource portfolios. Today many of the nation's natural gas utilities find themselves relying on short-term markets for most of their gas needs, with either the encouragement or the acquiescence of their regulators. During much of the 1990's this approach was typically advantageous to consumers, as the market price of natural gas was generally low and did not fluctuate dramatically. As wholesale natural gas prices have risen since 2000 and become more volatile, however, many utilities and commissions are reconsidering this emphasis on short-term market purchases.

While purchasing practices based on short-term supply contracts may offer consumers relatively low-cost natural gas, those consumers are also exposed to more volatile prices and natural gas bills that may rise and fall unpredictably. Public Utility Commissions should favorably consider gas distribution company proposals to manage volatility, such as through hedging, fixed-price contracts of various durations, energy-efficiency improvements in customers' buildings and equipment, and other measures designed to provide greater certainty about both supply

adequacy and price stability. Achieving these goals will sometimes require paying a premium over prevailing spot market prices. Like diversified investment portfolios that are designed to mitigate risk, prudent hedging plans should be encouraged as a way to help stabilize gas prices and ensure long-term access to affordable natural gas services.

This Joint Statement also has been reviewed and endorsed by:

ALLIANCE TO
SAVE ENERGY
Creating an Energy-Efficient World

Alliance to Save Energy

American Council for an Energy-Efficient Economy

L:NRDC-AGA Statement – 7-7-04 (FINAL with ACE3).doc

Resolution on Gas and Electric Energy Efficiency

WHEREAS, The National Association of Regulatory Utility Commissioners (NARUC), at its July 2003 Summer Meetings, adopted a *Resolution on State Commission Responses to the Natural Gas Supply Situation* that encouraged State and Federal regulatory commissions to review and reconsider the level of support and incentives for existing gas and electric utility programs designed to promote and aggressively implement cost-effective conservation, energy efficiency, weatherization, and demand response in both gas and electricity markets; *and*

WHEREAS, The National Petroleum Council (NPC), in its September 25, 2003 report on *Balancing Natural Gas Policy – Fueling the Demands of a Growing Economy*, found that greater energy efficiency and conservation are vital near-term and long-term mechanisms for moderating price levels and reducing volatility and recommended all sectors of the economy work toward improving demand flexibility and efficiency; *and*

WHEREAS, The NPC, in its report, identified key elements of the effort to maintain and continue improvements in the efficient use of electricity and natural gas, including (but not limited to):

(i) enhanced and expanded public education programs for energy conservation, efficiency, and weatherization,

(ii) DOE identification of best practices utilized by States for low-income weatherization programs and to encourage nation-wide adoption of these practices,

(iii) a review and upgrade of the energy efficiency standards for buildings and appliances (to reflect current technology and relevant life-cycle cost analyses) to ensure these standards remain valid under potentially higher energy prices

(iv) promote the use of high-efficiency consumer products including advanced building materials, Energy Star appliances, energy "smart" metering and information control devices

(v) on-peak electricity conservation to minimize the use of gas-fired electric generating plants,

(vi) the use of combined-cycle gas-fired electric generating units instead of less-efficient gas-fired boilers, and

(vii) clear natural gas and power price signals; and

(viii) remove regulatory and rate structure incentives to inefficient use of natural gas and electricity; and

WHEREAS, The NARUC, at its November 2003 annual convention, adopted a *Resolution Adopting Natural Gas Information "Toolkit"* which encouraged the NARUC Natural Gas Task Force, to review (among other things) the findings and recommendations in the NPC report that have regulatory implications for State commissions for improving and promoting energy efficiency and conservation initiatives, including consumer outreach and education, review of regulatory throughput incentives*; and*

WHEREAS, The American Council for an Energy-Efficient Economy ("ACEEE"), in its December 2003 report on *Responding to the Natural Gas Crisis: America's Best Natural Gas Energy Efficiency Programs*, (i) identified States and utilities with programs that many would consider best practice or model programs for all types of natural gas customers and all principal natural gas end-use technologies, and (ii) found that these programs are concentrated in relatively few States and regions and could be expanded in other parts of the country to great benefit; *and*

WHEREAS, the Natural Resources Defense Council (NRDC), the American Gas Association (AGA) and the ACEEE have recently adopted a Joint Statement noting that traditional rate structures often act as disincentives for natural gas utilities to aggressively encourage their customers to use less gas. Therefore, the NRDC, AGA, and the ACEEE have urged public utility commissions to align the interests of consumers, utility shareholders, and society as a whole by encouraging conservation. Among the mechanisms supported by these groups are the use of automatic rate true-ups to ensure that a utility's opportunity to recover authorized fixed costs is not held hostage to fluctuations in retail gas sales; *now therefore be it*

RESOLVED, That the Board of Directors of the National Association of Regulatory Utility Commissioners (NARUC), convened in its 2004 Summer Meetings in Salt Lake City, Utah, encourages State commissions and other policy makers to support the expansion of natural gas energy efficiency programs and electric energy efficiency programs, including those designed to promote consumer education, weatherization, and the use of high-efficiency appliances, where economic, and to address regulatory incentives to address inefficient use of gas and electricity; *and be it further*

RESOLVED, That the Board of Directors of the NARUC, encourages State and Federal policy makers to: (i) review and upgrade the energy efficiency standards for buildings and appliances, where economic, to ensure these standards remain valid under potentially higher energy prices, and (ii) promote the use of high-efficiency consumer products, where economic, including advanced building materials, Energy Star appliances, and energy "smart" metering and information control devices; *and be it further*

RESOLVED, That Board of Directors of NARUC encourages State Commissions to review and consider the recommendations contained in the enclosed *Joint Statement of the American Gas Association, the Natural Resources Defense Council, and the American Council for an Energy-Efficient Economy; and be it further*

RESOLVED, That the Board of Directors of the NARUC recognizes that the best approach towards promoting gas energy efficiency programs and electric energy efficiency programs for any single utility, State or region may likely depend on local issues, preferences and conditions.

Sponsored by the NARUC Natural Gas Task Force, Committee on Gas, Committee on Consumer Affairs, Committee on Electricity, and Committee on Energy Resources and the Environment
Adopted by the NARUC Board of Directors July 14, 2004

Resolution on Energy Efficiency and Innovative Rate Design

WHEREAS, The National Association of Regulatory Utility Commissioners (NARUC), at its July 2003 Summer Meetings, adopted a *Resolution on State Commission Responses to the Natural Gas Supply Situation* that encouraged State and Federal regulatory commissions to review the incentives for existing gas and electric utility programs designed to promote and aggressively implement cost-effective conservation, energy efficiency, weatherization, and demand response; *and*

WHEREAS, The NARUC at its November 2003 annual convention, adopted a *Resolution Adopting Natural Gas Information "Toolkit,"* which encouraged the NARUC Natural Gas Task Force to review the findings and recommendations of the September 23, 2003 report by the National Petroleum Council on *Balancing Natural Gas Policy – Fueling the Demands of a Growing Economy* and its recommendations for improving and promoting energy efficiency and conservation initiatives; *and*

WHEREAS, The NARUC at its 2004 Summer Meetings, adopted a *Resolution on Gas and Electric Energy Efficiency* encouraging State commissions and other policy makers to support expansion of energy efficiency programs, including consumer education, weatherization, and energy efficiency and to address regulatory incentives to inefficient use of gas and electricity; *and*

WHEREAS, These NARUC initiatives were prompted by the substantial increases in the price of natural gas in wholesale markets during the 2000-2003 period when compared to the more moderate prices that prevailed throughout the 1990s; *and*

WHEREAS, The wholesale natural gas prices of the last five years largely reflect the fact that the demand by consumers for natural gas has been growing steadily while, for a variety of reasons, the supply of natural gas has had difficulty keeping pace, leading to a situation where natural gas demand and supply are narrowly in balance and where even modest increases in demand produce sharp increases in price; *and*

WHEREAS, Hurricanes Katrina and Rita, in addition to damaging the States of Alabama, Mississippi, Louisiana, and Texas, significantly damaged the nation's onshore and offshore energy infrastructure, resulting in significant interruption in the production and delivery of both oil and natural gas in the Gulf Coast area; *and*

WHEREAS, The confluence of a tight balance of natural gas supply and demand and these natural disasters has driven natural gas prices in wholesale markets to unprecedented levels; *and*

WHEREAS, The present high and unprecedented level of natural gas prices are imposing significant burdens on the nation's natural gas consumers, whether residential, commercial, or industrial, and will likely be injurious to the nation's economy as a whole; *and*

WHEREAS, The recently enacted Energy Policy Act of 2005 contains a number of provisions aimed at encouraging further natural gas production in order to bring down prices for consumers,

but these actions, together with any further action on energy issues by Congress, are unlikely to bring forth additional supplies of natural gas in the short term; *and*

WHEREAS, Energy conservation and energy efficiency are, in the short term, the actions most likely to reduce upward pressure on natural gas prices and to assist in bringing energy prices down, to the benefit of all natural gas consumers; *and*

WHEREAS, Innovative rate designs including "energy efficient tariffs" and "decoupling tariffs" (such as those employed by Northwest Natural Gas in Oregon, Baltimore Gas & Electric and Washington Gas in Maryland, Southwest Gas in California, and Piedmont Natural Gas in North Carolina), "fixed-variable" rates (such as that employed by Northern States Power in North Dakota, and Atlanta Gas Light in Georgia), other options (such as that approved in Oklahoma for Oklahoma Natural Gas), and other innovative proposals and programs may assist, especially in the short term, in promoting energy efficiency and energy conservation and slowing the rate of demand growth of natural gas; *and*

WHEREAS, Current forms of rate design may tend to create a misalignment between the interests of natural gas utilities and their customers; *now therefore be it*

RESOLVED, That the National Association of Regulatory Utility Commissioners (NARUC), convened in its November 2005 Annual Convention in Indian Wells, California, encourages State commissions and other policy makers to review the rate designs they have previously approved to determine whether they should be reconsidered in order to implement innovative rate designs that will encourage energy conservation and energy efficiency that will assist in moderating natural gas demand and reducing upward pressure on natural gas prices; *and be it further*

RESOLVED, That NARUC recognizes that the best approach toward promoting energy efficiency programs for any utility, State, or region may likely depend on local issues, preferences, and conditions.

Sponsored by the Committee on Gas
Recommended by the NARUC Board of Directors November 15, 2005
Adopted by the NARUC November 16, 2005