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March 15, 2016 Docket No. 16-00028

Sharla Dillon
Dockets Manager
Tennessee Regulatory Authority
500 Deaderick Street, 4th Floor
Nashville, TN 37242

VIA E-MAIL AND HAND DELIVERY

RE: Atmos Energy Corporation

Dear Ms. Dillon:

Enclosed is a Petition to Revise Performance Based Ratemaking Mechanism Tariff Rider to be filed on behalf of Atmos Energy Corporation. With this Petition we are also filing a proposed Protective Order and Direct Testimony of Rebecca M. Buchanan and Mathew B. Davidson.

Ms. Buchanan's testimony contains three exhibits, one of which is confidential and is being filed under seal.

Also enclosed is our firm check in the amount of $25.00. If you have any questions, please let me know.

Best regards.

Sincerely,

A. Scott Ross

ASR:prd
Enclosures

cc: Wayne M. Irvin, Esq. (via email of non-confidential portions only)

BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

IN RE:	)	
	)	
IN RE:	)	
	)	
PETITION OF ATMOS ENERGY	)	
CORPORATION TO REVISE	)	
PERFORMANCE BASED	)	**TRA Docket No. 16-**
RATEMAKING MECHANISM TARIFF	)	
RIDER	)	

DIRECT TESTIMONY OF MATHEW B. DAVIDSON
ON BEHALF OF ATMOS ENERGY CORPORATION

Q.: **Please state your name, employer and business address.**

A.: My name is Mathew B. Davidson. I am employed by Atmos Energy Corporation ("Atmos Energy"). My business address is 1100 Poydras St, New Orleans, LA 70163, Suite 3400.

Q.: **What is your role at Atmos Energy Corporation?**

A.: I am the Director of Gas Supply and Services.

Q.: **Please describe your responsibilities as the Director of Gas Supply and Services.**

A.: I oversee gas supply planning and hedging for Atmos Energy. Gas Supply and Services is responsible for forecasting the natural gas requirements for Atmos Energy's regulated utility operations, including its operations in the state of Tennessee. Gas Supply and Services develops forecasts used for capacity planning and volumetric purchase requirements associated with Atmos Energy's utility operations. Additionally, Gas Supply and Services analyzes transportation and storage contracts, and recommends optimal supply portfolios and gas purchase arrangements. Gas Supply and Services has

the primary responsibility for managing Atmos Energy's capacity entitlements on over 30 different pipelines across our various service territories, many of which are used in connection with our local distribution service in Tennessee.

EXETER ASSOCIATES, INC.'S RECOMENDATIONS

Q.: Are you familiar with Exeter Associates, Inc.'s (Exeter) review of Atmos Energy Corporation's Performance Based Ratemaking Mechanism Rider (PBRM)?

A.: Yes, I have read Exeter's review.

Q.: Would you briefly summarize Exeter's recommendations for Atmos' PBRM?

A.: Exeter recommends that Atmos have a PBRM that consists of two components: (1) a Gas Procurement Incentive Mechanism (GPIM); and (2) a Capacity Management Incentive Mechanism (CMIM).

The GPIM establishes a monthly cost benchmark to which the Company's purchased cost of gas commodity is compared. It also reflects the possibility that Atmos could use financial instruments or private contracts to manage gas costs and achieve savings. Exeter proposes that GPIM calculations also include avoided demand charges for the capacity portfolio used to serve the Company's customers. Exeter recommends that savings generated from the GPIM be shared between the Company and its customers on a 75/25 percent basis for "new" arrangements and on a 90/10 percent basis for "replacement" arrangements. Previously these savings were shared on a 50/50 percent basis, subject to an annual cap of $1.25 million on all shared savings under the PBRM plan.

The CMIM is designed to incentivize Atmos to release daily transportation and daily storage capacity, or realize margins from asset management agreements (AMAs) and off-

system sales to generate savings for customers by allowing Atmos to share a percentage of the fees and other compensation generated through such activities. Exeter recommends that savings generated from the CMIM be shared on a 90/10 percent basis for AMA-related payments and on a 75/25 percent basis for capacity release and off-system sales activities engaged in directly by the Company.

Q.: What are "avoided demand charges?"

A.: Exeter explains that in the current PBRM "avoided demand charges" refer specifically to demand charges associated with delivered-to-citygate gas supply arrangements. To the extent that Atmos can use delivered-to-citygate gas supply arrangements to serve customers at a cost less than that of holding firm pipeline contracts to the same citygates, Exeter recommends that such savings be included in the PBRM as part of the GPIM calculations. Exeter's report also indicates that there are other ways to avoid demand charges.

Q.: What other demand charge reductions does Exeter recommend be included in the PBRM?

A.: Exeter recommends that other efforts by Atmos to reduce demand charges should be included in the PBRM because these efforts also reduce purchased gas costs. I agree with Exeter that there are other ways to avoid demand charges. This would include, among other things, replacing transportation agreements with less expensive transportation agreements. These savings would also be reflected in the GPIM.

Q.: Do you agree with Exeter's recommendations?

A.: Yes.

SAVINGS CALCULATIONS

Q.: How does Exeter recommend "avoided demand charges" and "other demand charge reductions" should be shared between Atmos and the customers through the PBRM?

A.: As previously mentioned, these types of savings fall under the GPIM category. Exeter recommends that savings in the GPIM be shared on either a 75/25 percent basis or a 90/10 percent basis depending upon whether the particular arrangement for the savings is a "new" or a "replacement" arrangement. In either case, the larger percentage of the savings would be allocated to customers, whereas savings were previously split between customers and the Company on a 50/50 basis.

Q.: How should any savings from "avoided demand charges" and "other demand charge reductions" be calculated?

A.: The appropriate starting point for calculating savings is to compare the cost paid by Atmos with the maximum tariff rate for firm service to the primary delivery point(s) being served.

Q.: **What is the difference, if any, between savings from "avoided demand charges" and "other demand charge reductions?"**

A.: Fundamentally, there is no difference. In order to be able to meet its customers' natural gas needs, Atmos either has to hold firm transportation contracts sufficient to meet each delivery point's (or delivery area's) maximum possible demand, or has to arrange for equivalent capacity through alternate means. As examples, to the extent that Atmos is able to enter into a lower cost delivered service arrangement, capacity release arrangement, or discounted pipeline contract to provide the same level of service to

customers, Atmos is saving customers the cost of firm capacity at tariff maximum rates. The amount of the resultant savings is measured, therefore, by comparing the cost of the alternate, lower cost arrangement to the cost of firm capacity at tariff max rates.

Q.: Why is the maximum tariff rate the right number upon which to base savings calculations?

A.: The maximum tariff rate is the correct value to use for several reasons:

First, for interstate pipelines, maximum tariff rates represent a cost of service rate that the Federal Energy Regulatory Commission (FERC) has determined to be just and reasonable. These rates are arrived at through FERC rate case proceedings. In all cases, pipeline tariff rates are certified by an Administrative Law Judge and then must be accepted or approved by the FERC Commissioners as just and reasonable.

Second, in order for a pipeline to grant a discount pursuant to FERC's discounting policy, that discount must be found to benefit the pipeline's customers, and ultimately result in more throughput than would have been possible without the discount, thus reducing overall rates on the pipeline. Pipeline discounts are not granted because the discounted rate represents the true cost of service or the just and reasonable rate. Rather, discounts are granted only when the shipper receiving the discount can demonstrate to the pipeline that absent that discount, it would not execute the contract with that pipeline. This is often very difficult to demonstrate to the pipelines and that is why discounted firm pipeline contracts are unusual.

Third, the nature of LDC service is such that it is harder for LDCs to achieve pipeline discounts than other types of shippers.

Q.: What rate would Atmos pay if it needed capacity at a new delivery point or additional capacity at an existing delivery point?

A.: That would depend upon many factors, but unless Atmos qualified for a discount from the pipeline under the FERC's discounting policy, most likely by having the ability to acquire capacity from more than one pipeline at that point, I would expect Atmos to pay the maximum tariff rate for a new contract with the pipeline.

Q.: What happens if a pipeline grants a discount to a shipper that does not qualify under FERC's discounting policy?

A.: If a discount is granted that does not comply with FERC's discounting policy, then that pipeline is not allowed to reflect that discount in its subsequent rate cases. Effectively that pipeline would give up any opportunity to recover the portion of its cost of service foregone through the granting of that discount. As I previously mentioned, in order for a discount to qualify under FERC's discounting policy, the pipeline has to be able to show that absent that discount the shipper would not have signed that contract and would not be paying those discounted demand charges, effectively raising the overall cost of service for the pipeline's other customers.

Q.: Why did you say that the nature of LDC service makes it harder for LDCs to achieve pipeline discounts than other types of shippers?

A.: LDC's are often captive, especially at their citygates. A captive customer almost never qualifies for a discount under FERC's discounting policy, unless it can credibly and economically build new facilities to bypass the serving pipeline. An LDC is not like an industrial shipper that can move a factory, shift production to another facility, or change

to an alternate fuel source. An LDC is not like a producer than can negotiate a long-term discount prior to drilling. LDCs do not get to choose where their delivery points will be.

Q.: Are there any other reasons that you believe the maximum tariff rate is the right number upon which to base savings calculations?

A.: Yes, because that is the only valid basis for comparison. In our other state PBRMs, pipeline discounts are always compared to the maximum tariff rate, never to a "market" rate or an "average" rate. This is because there is no published "market" rate or "average" rate for pipeline capacity. The FERC tariff rate is the only consistently available "price" of pipeline capacity. While there are occasions when a shipper may be able to obtain a discount from the FERC tariff rate, as discussed above, it is not possible to use such transactions to establish a benchmark market "price" for given pipeline capacity for multiple reasons.

First, data about discounted capacity "prices" are not widely available or systematically collected or reported. The data that would be needed to establish a valid market "price" for given capacity simply does not exist.[1]

Second, when anecdotal information about past discounts is available, these isolated data points do not establish meaningful price benchmarks due to the controlling influence of differences among transactions, both in terms of when they occur and the specific characteristics of each contract.

From one year to another, the price for capacity, especially future capacity, can vary widely. For example, if parties believe that LNG exports will increase at a certain date in the future from a terminal served by a pipeline, the capacity that would potentially serve that terminal would see its value increase. And even for contracts under the same rate

[1] Pipelines are only required to post discounted rates for ninety days after a discount is granted (18 CFR 284.13).

schedule on the same pipeline, different contracts can have very different values based upon characteristics unique to each contract, such as primary receipt/delivery points, transportation paths, and any additional restrictions placed on the contract by the pipeline. If a pipeline were to experience a constraint at a certain point or points, the value of a transportation path through that constraint would increase. It would have a greater value than an unconstrained path, even if both paths had the same maximum tariff rate.

Q.: Can parties ever see the "true" cost of capacity on a pipe?

A.: The "true" cost of capacity on a pipeline is the maximum tariff rate. That tariff rate is the only rate that all parties can consistently see, and it is set by FERC based upon the just and reasonable cost of service.

Q.: What would be required to truly compare two pipeline contracts?

A.: Essentially it is impossible to make an "apples to apples" comparison between two pipeline contracts. In order for contracts to be comparable, they would need to be the same rate schedule on the same pipeline, have identical receipt and delivery points, have been negotiated at the same time, have a similar contractual term, and be with shippers that have similar load profiles. Even then the two contracts likely would not settle at the same price, because the price of each contract would be strongly influenced by each individual shipper's unique demand characteristics (the extent to which that shipper has other shipping options) and the remaining available capacity on the pipeline when each shipper closes his particular deal.

NEGOTIATING DISCOUNTS

Q.: How does the Company negotiate discounted contracts with interstate pipelines?

A.: We are sometimes able to negotiate discounted transportation agreements. When we are, it is because the Company has been able to demonstrate that it has alternate supply options; multiple possible supply paths on the same pipeline; and/or an ability to bypass a particular pipeline. It is only through convincing the pipelines that a discount would comply with FERC's discounting policy that we are sometimes able to obtain a discounted rate.

Q.: How hard is it to make such a showing to a pipeline?

A.: The amount of effort required to make such a showing can vary widely depending on market conditions. The pipeline employees that I interact with are typically very concerned with making sure that any discounts granted to Atmos comply with the FERC's discounting policy. I have to demonstrate to pipelines that I have cheaper alternatives to their service in order to get a discount. I have had to provide written documentation demonstrating Atmos' eligibility for a discount, such as a rate offer from another pipeline or a capacity release posting for comparable capacity of a comparable term with similar pipeline entitlements. Of course, all of this takes considerable time and effort, and is never guaranteed to be successful.

Q.: Have you had experience negotiating with a pipeline for several capacity contracts at once, which resulted in some of the contracts being issued at a discount and others being issued at maximum tariff rates?

A.: Yes. I have experienced this and this can occur for a variety of reasons. For example, some delivery points may be captive to the pipeline and not eligible for a discount while other delivery points may have competitive alternatives. Another possibility is that the pipeline believed that it would be able to sell some of its capacity at its maximum rate through an open season and thus we could not get a discount in those areas.

Q.: Is there another way to acquire discounted capacity?

A.: Sometimes, discounted capacity can be acquired through capacity releases with other shippers on a pipeline. Since the Company's capacity needs are highly specific, these releases usually take the form of pre-arranged capacity releases where the Company and the releasing shipper negotiate the terms of the release. More specifically, we may negotiate the receipt and delivery points and, if applicable, the transportation path. The goal is to find a transport solution that is more economically efficient (and therefore cheaper) for the Company. It is a time consuming and resource intensive process to find a willing counterparty with capacity that is the right fit and can be utilized on a primary firm basis to replace capacity that would have otherwise been contracted with the pipeline. The transportation path, access to supply, secondary utilization rights, and term all must be suitable to replace pipeline capacity at a rate lower than the pipeline's maximum tariff rate. This release is then posted as a biddable release and the Company retains the right to match any third party's higher bid.

Delivered service does not involve the Company executing a discounted transportation agreement with a pipeline, but results in the same outcome. For a delivered service, rather than working with the interstate pipeline, we negotiate with suppliers to provide the service utilizing their pipeline capacity rights. The Company's customers receive needed

natural gas supply without incurring the pipeline's full demand charges. Whether the Company uses delivered service, a discounted capacity arrangement, or acquires capacity through a capacity release, the Company is avoiding pipeline demand charges at FERC tariff max rates.

"NEW" AND "REPLACEMENT" ARRANGEMENTS

Q.: You mentioned that Exeter Associates, Inc. recommended different savings sharing percentages for avoided cost arrangements depending upon whether an arrangement was "new" or a "replacement" arrangement. How would you determine if an arrangement was a "replacement" arrangement or a "new" arrangement?

A.: Under a new PBRM, all arrangements initially should be viewed as "new." After three years, when evaluating subsequent arrangements to determine if they are "replacement" arrangements, a number of factors must be considered. Atmos' proposed tariff changes suggest that a "replacement" arrangement is one that is "essentially the same contractual service." (4th Revised Sheet No. 45.2) Thus, to determine whether or not a subsequent contractual arrangement is a "replacement" arrangement, I would look at the terms and conditions of the various types of contractual arrangements Atmos enters into.

For pipeline transportation contracts, principal consideration should be given to the contract's primary receipt and delivery points. For delivered supply, the delivery point and the counterparty should be the principal considerations.

For a pipeline transportation contract that involves the same volumes, with the same counterparty, pursuant to the same rate schedule at the same receipt and delivery points, the presumption should be that contract is a "replacement" arrangement.

For a delivered supply arrangement, the analysis is a little different. If a delivered supply arrangement were negotiated with the same counterparty for service to the same delivery point(s), then the presumption should be that it is a "replacement" arrangement.

Q.: Are those the only examples of "replacement" arrangements?

A.: No. While in most places replacing one upstream pipeline with a different upstream pipeline would be a "new" arrangement, for a specific supply area like middle Tennessee, it would be possible to "replace" an arrangement on one pipeline with an arrangement on another pipeline. Also, an agreement could be both a "replacement" arrangement and a "new" arrangement at the same time. An existing arrangement could be renewed or extended while simultaneously being modified to include a new arrangement.

For example, a discounted transportation contract with a pipeline for 1,000 Dth could be replaced with a new discounted transportation contract with the same pipeline for 1,100 Dth. The 1,000 Dth would be a "replacement" arrangement eligible for 90/10 percent savings split. The additional 100 Dth would be a "new" arrangement eligible for a 75/25 percent savings split.

Similarly, a discounted transportation contract with a pipeline for 1,000 Dth could be replaced with a new discounted transportation contract with the same pipeline for 1,000 Dth. If the discount off of the maximum tariff rate were increased by four cents, the original discount amount should be eligible for a 90/10 percent savings split while the

additional discount should be considered a "new" arrangement eligible for a 75/25 percent savings split.

I can also conceive of situations involving a hybrid of these two examples.

Q.: Would you provide some additional examples of "replacement" arrangements?

A.: Yes.

A delivered service agreement with a counterparty that lasted three years and was then extended or renewed at the same rate would be a "replacement" arrangement eligible for a 90/10 percent savings split.

In some cases if it were permitted under a transportation contract, the Company would let an agreement terminate on March 31st, at the end of the winter season, and not enter into a replacement arrangement until November 1st, at the beginning of the next winter season. The avoided demand charges in the summer would clearly constitute demand charge savings eligible for a 75/25 percent savings split as a "new" arrangement. If the contract beginning November 1st was at the same rate, quantity, terms and conditions as the contract terminated on March 31st, it would be a "replacement" arrangement eligible for a 90/10 percent savings split.

A contract for service to multiple points that was broken up into multiple contracts serving the same points could be a "replacement" arrangement, assuming that the quantities, term and conditions, and pricing did not change.

Q.: Do you believe a delivered supply arrangement could ever be viewed as being "replaced" by a discounted transportation contract arrangement or vice-versa?

A.: No. Delivered supply is fundamentally different from transportation capacity. If the Company was able to use one as a substitute for another, it should be considered a "new" arrangement. One could not be viewed as "essentially the same arrangement" as the other.

Q.: Did Exeter discuss what would happen if an arrangement was in place for three years, then terminated, and then was entered into again?

A.: No, in such a situation, it would be appropriate to consider a subsequent arrangement a "new" arrangement, provided at least one year had elapsed between the original and the subsequent arrangement. If less than one year had elapsed, then I would view it as a "replacement" arrangement eligible for a 90/10 percent savings split.

Q.: Why one year?

A.: The reason for the one year time limit is that many arrangements are seasonal in nature. It would not be appropriate to consider a seasonal arrangement as "new" if entered into every season.

Q.: Does this conclude your testimony?

A.: Yes.

Mathew B. Davidson

STATE OF LOUISIANA)
)
PARISH OF Orleans)

SWORN to and subscribed before me
this 1st day of March, 2016.

Notary Public

My Commission Expires: at death

Phyllis L. Trahan
Notary Public, ID No. 139029
State of Louisiana
My Commission is issued for Life