

OFFICE OF GENERAL COUNSEL

GUD No. 9732

Atmos Energy Corp., Mid-Tex Division, Gas Cost Review in Compliance with 8664 and 9400

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PROPOSAL FOR DECISION **PROCEDURAL HISTORY**

DATE FILED: May 1, 2007
HEARING DATE: September 3, 2008
HEARD BY: John Chakales, Hearings Examiner
Mark Evarts, Technical Examiner
PFD CIRCULATION DATE: December 18, 2008
STATUTORY DEADLINE: none

1. Overview of the Case

This docket concerns the Railroad Commission of Texas' ("Commission") review of the gas purchases of Atmos Energy Corp., Mid-Tex Division ("Atmos"). The period of time under review is November 1, 2003 through October 31, 2006. Atmos has been required by previous Commission orders to file with the Commission certain gas cost data for review by the Commission.¹ In addition to the evidence provided by Atmos in this case, several parties intervened and participated in the final hearing. After conducting the final hearing in this matter, and reviewing all the evidence presented in this docket, the Examiners conclude that Atmos' gas purchases during the review period comply with the applicable legal standard and were therefore prudent.

2. Procedural History and Notice

On April 30, 2007, Atmos filed its gas cost review data and testimony with the Commission. At the request of the parties to this proceeding, the procedural schedule was extended to accommodate a final hearing date of September 3, 2008. The Notice of Hearing was issued in this Docket on July 21, 2008, and satisfied the requirements of 16 TEX. ADMIN. CODE § 1.45 and TEX. GOV'T CODE ANN. § 2001.052 (Vernon 2000 & Supp. 2007). The final hearing in this matter was conducted on September 3 - 5, 2008.

3. Jurisdiction

The Commission has jurisdiction over the matters at issue in this proceeding under TEX. UTIL. CODE ANN. §§ 102.001(a), 104.001, 121.051, and 121.151 (Vernon 2007). The statutes and rules involved include, but are not limited to TEX. UTIL. CODE ANN. §§ 104.001, 104.002, 104.003, 104.004, 104.005, 104.008, 104.051, and 104.055 (Vernon 2007) and 16 TEX. ADMIN. CODE Chapters 1 and 7.

4. GUD Nos. 8664 and 9400 Gas Cost Review Requirements

The purpose of this docket is to conduct a triennial review of the gas purchases made by Atmos and to determine if those purchases were prudently made. Two Commission final orders have established the framework for this proceeding – GUD Nos. 8664 and 9400.

Gas Utility Docket No. 8664

In GUD No. 8664, the Commission issued a final order requiring the predecessor in interest of Atmos² to file with the Commission every 36 months an application for a reconciliation proceeding to demonstrate that its gas costs were reasonable and necessary. The GUD No. 8664 final order imposed limitations on what gas costs the Commission would consider reasonable and necessary and, as a result, Atmos' recovery of its cost of purchased gas is limited by the following

¹ See Gas Utilities Docket Nos. 8664 and 9400.

² Lone Star Gas Company

restrictions:

1. Affiliate purchases may be included at the lowest price charged by the affiliated supplier to other divisions or third parties.
2. Spot purchases made to cover imbalances to transportation customers may not be included.
3. The duplicative approximately \$0.58 per Mcf NGPA §311 transport fee component for LSGCOT/ONEOK purchases may not be included.
4. Any similar double charges for transportation due to an NGPA §311 rate charged for service that is implicitly contained in the city gate rate, or any other cause, may not be included.
5. Charges under the LSGCOT/ONEOK contract may be included at LSGCOT's actual cost.
6. Charges by affiliates of any margin above the affiliate's cost of gas may not be included.
7. Take-or-pay payments to affiliated companies may not be included unless Lone Star (Atmos) obtains the approval of the Director of the Gas Services Section in writing prior to inclusion, *i.e.*, Contract No. 3708, Enserch Exploration, Inc.³

Gas Utility Docket No. 9400

In GUD No. 9400, the Commission approved a new purchased gas adjustment clause for use by Atmos.⁴ The Commission approved Schedule R, which contains certain detailed filing requirements that standardizes the content of Atmos' gas cost review filing. Schedule R requires Atmos' Gas Purchase Report to include a gas contract index, contract summaries, schedule of monthly gas purchases, a statement of hedging procedures and a schedule of hedging activities (if applicable).⁵

Atmos is required to include the contract number, effective date, type of contract, Mcf purchased, MMBtu purchase, purchase amount, and \$ per MMBtu in the gas contract index. The contract summary includes the contract number, date, type of purchase, terms, cancellation date,

³ GUD No. 8664, Second Order on Rehearing Nunc Pro Tunc, *Statement of Intent by Lone Star Gas Company and Lone Star Pipeline Company, Divisions of Enserch Corporation, and ENSAT Pipeline Company to Increase Intracompany City Gate Rate*, dated November 25, 1997.

⁴ GUD No. 9400 set rates for TXU Gas prior to that utility being acquired by Atmos.

⁵ GUD No. 9400, Final Order, *Statement of Intent Filed by TXU Gas Company to Change Rates in the Company's Statewide Gas Utility System*, dated May 25, 2004.

penalty provisions (both imbalance and payment or any other penalty provisions), pricing, minimum and maximum daily quantities, and seasonal minimum and maximum quantities. The Monthly gas purchase schedules include a schedule of gas purchases by month, by contract (affiliates must be identified), purchase price, average BTU content per month, Mcf purchased each month, and MMBtu purchased each month. The statement of gas hedging procedures is a written statement of hedging policies and procedures. The hedging schedule includes a listing of gains/losses applied to sales customers via CGA or other applicable surcharge mechanism.

5. Standard of Review

At the October 9, 2007 Conference, the Commission set the standard for review for this docket. The Commission ruled that the appropriate legal standard for determining the prudence of Atmos' gas purchases during the review period is that which is set forth in the *Gulf States*⁶ case. Prudence is defined as the exercise of that judgment and the choosing of that select range of options which a reasonable utility manager would exercise or choose in the same or similar circumstances given the information or alternatives at the point in time such judgment is exercised or option is chosen.⁷ Prudent decision-making by a utility may be demonstrated in one of two ways: (1) the utility may demonstrate that its decision-making process was prudent; or (2) that the same decision is in the select range of options that would have resulted had prudent decision-making been employed.⁸

Under the first method (proving that its decision-making process was prudent), a utility presents contemporaneous documentation of its decision-making process. This enables a regulatory authority to review the actual investigations and analyses leading to the utility's decision.⁹ If there is no evidence of contemporaneous investigation and analysis, the utility must establish prudence by demonstrating that its decisions are in the select range of options that would have resulted had prudent decision-making been employed. The regulatory authority must analyze the prudence of the decisions after-the-fact.¹⁰ This is referred to as a retrospective analysis. An "attempt to demonstrate prudent decision-making by retrospective analyses is inherently defensive and hence more suspect."¹¹ Through independent retrospective analyses, the utility must demonstrate that a reasonable utility manager, having investigated all relevant factors and alternatives as they existed at the time the decision was made, would have found the utility's actual decision a reasonably prudent course.¹²

⁶ *Gulf States Utilities Co. v. Public Utility Comm'n of Texas*, 841 S.W.2d 459 (Tex. App. – Austin, 1992).

⁷ *Gulf States Utilities Co. v. Public Utility Com'n of Texas*, 841 S.W.2d 459, 475 (Tex.App. – Austin 1992)

⁸ *Gulf States* at 475-476.

⁹ *Gulf States* at 476.

¹⁰ *Gulf States* at 476.

¹¹ *Gulf States* at 476.

¹² *Gulf States* at 476.

Additionally, the Gas Utilities Code provides that the Commission shall ensure that each rate a gas utility makes, demands, or receives is just and reasonable.¹³ A gas utility is allowed to recover in its revenues its reasonable and necessary operating expenses.¹⁴ In rate proceedings the gas utility has the burden of proving that its rates are just and reasonable.¹⁵ Rule §7.503 provides that in proceedings before the Commission, the amounts shown on the books and records of a gas utility that keeps its books and records in accordance with Commission rules are considered prima facie evidence of the amount of investment or expense reflected when introduced into evidence, and such amounts are presumed to have been reasonably and necessarily incurred. If any evidence is introduced that an investment or expense item has been unreasonably incurred, then the presumption as to that specific investment or expense item shall no longer exist and the gas utility shall have the burden of introducing probative evidence that the challenged item has been reasonably and necessarily incurred.¹⁶ In this proceeding, Atmos' gas purchases during the 36-month review period are being reviewed to determine if they were reasonable and necessary and whether Atmos was prudent in its gas purchasing practices and decisions.

6. Atmos Energy Corp.'s Position

Atmos argues extensively that it has clearly established that its gas purchases during the review period were reasonable, necessary and prudent. Atmos supported its gas cost review filing with the direct testimony of five witnesses; Barbara Myers, Alan Anderson, Richard Boerner, Richard Erskine and Ronald Sellars.¹⁷ The utility takes the position that it has satisfied its burden of proof in this proceeding for three reasons. One, Atmos provided all information required under Schedule R, including evidence from expert witnesses addressing the reasonableness and necessity of the gas purchases. Two, Rule §7.503 establishes that Atmos' gas costs were reasonable and necessary and no evidence has effectively changed the evidentiary treatment of its gas cost data. Three, the evidence shows that Atmos has complied with all restrictions imposed by GUD No. 8664.¹⁸ Atmos argues that the Commission required the intervenors to present "specific evidence" regarding gas purchases in order to rebut the "reasonable and necessary" presumption established under §7.503. Atmos argues that no intervenor presented evidence to rebut this presumption and therefore the reasonableness and necessity of Atmos' gas purchases is uncontroverted.¹⁹

Ms. Barbara W. Myers, a Regulatory Accounting Manager for Atmos Energy Corp., testified that during the 36-month review period, Atmos' accounting records were kept in accordance with the applicable rules and regulations of the Commission.²⁰ Ms. Myers also testified that the filing

¹³ TEX. UTIL. CODE ANN. § 104.003(a) (Vernon 1998 & Supp. 2006).

¹⁴ TEX. UTIL. CODE ANN. § 104.051 (Vernon 1998 & Supp. 2006).

¹⁵ TEX. UTIL. CODE ANN. § 104.008 (Vernon 1998 & Supp. 2006).

¹⁶ 16 TEX. ADMIN. CODE §7.503(a) (2002)

¹⁷ Originally, Mr. C. Michael Wollitz submitted direct testimony on behalf of Atmos. Mr. Wollitz retired before the final hearing. Other witnesses for Atmos sponsored portions of Mr. Wollitz's original testimony and testified in regards to certain areas that Mr. Wollitz originally addressed.

¹⁸ See, Atmos Initial Brief, pp. 13-18.

¹⁹ See, Initial Brief of Atmos at 2-3.

²⁰ Atmos Exhibit 1, Direct Testimony of Barbara Myers.

made by Atmos in this docket complies with and contains all the required data and information required by Schedule R to final order issued in GUD No. 9400. Ms. Myers additionally testified with regards to the accounting systems used by Atmos and their relevance to evaluating gas purchasing costs.

Dr. Alan D. Anderson, President of Energy Planning, Inc., testified on his evaluation of Atmos' gas purchases during the review period (November 1, 2003 through October 31, 2006). Dr. Anderson testified that Atmos' use of spot, peaking, and baseload contracts was reasonable and necessary and that Atmos used procedures to ensure that prices under the contracts were just, reasonable and necessary. He testified that the level of hedging adopted by Atmos and that implementation of its hedging policies was reasonable and necessary.²¹

Mr. Richard A. Boerner, a Senior Gas Supply Representative for Atmos Energy Corp., testified on Atmos' winter planning, gas purchasing and contract administration and adopted related portions of Mr. Wollitz' direct testimony.²² Mr. Boerner's testimony addressed the steps and processes that Atmos goes through in meeting the gas supply needs of its customers. His testimony covers the company's forecasting for customer needs, gas supply planning and the implementation of gas supply plans. He testified that the purchases made during the review period were reasonable and necessary.

Mr. Richard A. Erskine, President of Atmos Pipeline, testified on overall gas purchasing strategy and policy and on compliance with the final order issued in GUD No. 8664.²³ Mr. Erskine adopted the related portions of Mr. Wollitz' direct testimony. Mr. Erskine testified that Atmos' two primary goals are (1) ensuring that service is provided in a reliable fashion and (2) ensuring that Atmos has the flexibility to also provide service at a reasonable price. Mr. Erskine testified that one of Atmos' goals was to establish a known price for approximately 45% of the expected winter season gas supply. He testified that the company's processes resulted in gas purchases during the review period that were reasonable.

Mr. Ronald K. Sellars, a Gas Coordinator for Atmos Energy Corp., testified on behalf of Atmos in regards to the daily supply planning and implementation process and adopted related portions of Mr. Wollitz' direct testimony.²⁴ Mr. Sellars testimony describes the daily gas planning process that Atmos engages in prior to making purchases. He testified that the processes employed by Atmos enabled the utility to "meet its customers needs at prevailing market prices by developing and implementing its fully-documented daily and annual planning processes. Atmos also utilized publicly available market indices in addition to its RFP and negotiation process to develop a supply mix that satisfied its customers' needs on a reliable basis and at a reasonable price."²⁵

²¹ Atmos Exhibit 2, Direct Testimony of Alan Anderson.

²² Atmos Exhibit 3, Direct Testimony of Richard Boerner.

²³ Atmos Exhibit 4, Direct Testimony of Richard A. Erskine.

²⁴ Atmos Exhibit 5, Direct Testimony of Ronald K. Sellars.

²⁵ *Id.* at 25.

7. Intervenor Arguments

City of Dallas

Jacob Pous testified on behalf of Dallas during this proceeding. Mr. Pous is a consultant with Diversified Utility Consultants, Inc. Mr. Pous testified that Atmos failed “to purchase gas in a prudent manner for the 2005-2006 winter period (November 2005 through March 2006).”²⁶ Mr. Pous testified that “the Company unreasonably delayed the 2005-2006 Plan conversion of index-based winter base load contracts to a fixed-price during the spring and summer of 2005. That delay resulted in customers being requested to pay for locked in gas as high as \$13.12 per MMBtu.”²⁷ Mr. Pous recommends that Atmos be denied \$57,946,061 in gas purchase costs based on the alleged imprudent gas purchasing.

Dallas alleges that Atmos did not prudently plan and execute its winter gas purchasing plan for the 2005-2006 winter gas purchasing season. Dallas alleges that Atmos delayed implementing its gas purchasing plan until July 25, 2005, and was therefore imprudent. Dallas also alleges that Atmos delayed locking-in the contract price for baseload gas until August 25, 2007. As a result of these delays, Atmos’ gas purchasing was exposed to the market effects of Hurricanes Katrina and Rita with the result being that Atmos locked in gas prices at a significant premium to what it could have locked in prices had Atmos initiated its gas price volatility mitigation plan earlier.²⁸ Mr. Pous quantified Atmos’ locking of prices versus when he finds Atmos should have locked in prices and calculates \$57,946,061 in unreasonable gas costs as a result of Atmos’ alleged imprudence.²⁹ Dallas specifically challenges the prudence of the following Atmos gas purchase contracts: PUR07138, PUR07160, PUR07179, PUR07183, PUR07187, PUR07189, PUR07192, PUR07203, PUR07213, PUR07217, PUR07218, PUR07220, PUR07223, PUR07226, and PUR07230.³⁰ Mr. Pous “found that the company unreasonably delayed the conversion of index prices to fixed prices for the 2005-2006 winter season, the delay or non action being during the spring and summer of 2005.”³¹ Dallas alleges that this delay resulted in customers being charged as much as \$13.12 per MMBtu for a large portion of locked in gas. Dallas alleges that Atmos should have locked in prices earlier and that these delays resulted in \$57,946,061 in unreasonable gas costs.

Atmos Cities Steering Committee

Karl J. Nalepa testified on behalf of ACSC during this proceeding. Mr. Nalepa is a

²⁶ Dallas Exhibit 1, Pous Direct Testimony at 4.

²⁷ *Id.*

²⁸ *See*, Initial Brief of the City of Dallas, pp. 1 – 2, 5– 11.

²⁹ Dallas Exhibit 1, Pous Direct Testimony at 28-31.

³⁰ Dallas Exhibit 1, Pous Direct Testimony at 28.

³¹ *See*, Initial Brief of the City of Dallas at 5-6.

Managing Director with RJ Covington Consulting, a utility consulting firm. Mr. Nalepa testified that Atmos “failed to implement its Annual Gas Supply price mitigation plans, resulting in: (1) unreasonable prices and higher costs to customers under its fixed price baseload contracts; and failure to use gas in storage at a known price to reduce the cost of gas to customers.”³² ACSC alleges that Atmos was imprudent in its gas purchasing in two respects. “First, by unreasonably delaying the adoption of the 2005-2006 Plans and then delaying even longer the implementation of those Plans, Atmos was imprudent and did not act as a reasonable utility manager would have acted in those same circumstances. Atmos also acted imprudently by deviating from the Plans in September and October 2004.”³³ ACSC alleges that these imprudent actions resulted in: “(1) unreasonable prices and higher costs to customers under its fixed price baseload contracts; and (2) higher costs to customers because of Atmos’ failure to use gas in storage at a known price to reduce the cost of gas to customers. As a result, Atmos’ gas costs should be reduced by a total of \$89,156,323.”³⁴ Mr. Nalepa testified that gas costs should be reduced by \$63,579,488 to account for revised price lock-in decisions under certain baseload contracts and that a \$25,576,835 reduction should be made to account for more effective use of gas in storage.³⁵ He recommends that the adjustments be included in Atmos’ annual reconciliation filing as a credit to natural gas expense and flowed back through the customers’ gas cost adjustment factor.

ACSC also alleges that Atmos was imprudent in its use of gas in storage.³⁶ Mr. Nalepa testified that “Atmos did not maximize the value of its natural gas storage capacity, and consequently the cost to ratepayers was higher than necessary.”³⁷ “Atmos did not effectively dispatch storage relative to other market supply options to minimize costs.”³⁸ He testified that by “failing to withdraw the gas as planned, Atmos effectively missed its hedging goal, and imprudently incurred additional costs. Atmos’ actions are contradictory to the stated significant focus of its planning process, which is limiting the exposure of the gas supply portfolio to the daily spot market and participating in a declining spot environment.”³⁹

State of Texas

The State of Texas intervened in this proceeding and participated during the final hearing of this docket. The State offered no expert testimony in this proceeding. The State participated during the final hearing and submitted a post-hearing brief and reply brief. The State argues that Atmos was imprudent in devising and implementing the company’s annual gas supply plans.⁴⁰ The State also argues that Atmos imprudently managed its gas storage during the heating season.⁴¹ In

³² ACSC Exhibit 1, Nalepa Direct Testimony at 7.

³³ See, Initial Brief of Atmos Cities Steering Committee at p. 2.

³⁴ *Id.* at 3.

³⁵ ACSC Exhibit 1, Nalepa Direct Testimony at 7.

³⁶ *Id.* at 20 – 23.

³⁷ ACSC Exhibit 1, Nalepa Direct Testimony at 23.

³⁸ ACSC Exhibit 1, Nalepa Direct Testimony at 24.

³⁹ ACSC Exhibit 1, Nalepa Direct Testimony at 25 – 26.

⁴⁰ See, Initial Brief of State of Texas, at 5 – 9.

⁴¹ See, Initial Brief of State of Texas, at 9 – 10.

its post-hearing briefing, the State essentially adopts and argues the positions advocated by ACSC witness Karl Nalepa.⁴²

Railroad Commission Staff

The Railroad Commission Staff intervened in this proceeding and participated during the final hearing of this docket. Staff offered no expert testimony in this proceeding. Staff submitted a post-hearing brief and reply brief which addressed the issues raised in the final hearing. In its briefing Staff argues that it “believes Atmos did not prove that its management exercised reasonable judgment (1) when management significantly delayed approval of the company’s gas supply plan to July 25, 2005 and (2) when management did not direct its gas buyers to catch-up to the plan by locking in prices for planned volumes of gas in late July and early August, immediately after plan approval.”⁴³ Staff argues that this resulted in \$63.5 million in imprudent gas purchases by Atmos.

In addition to recommending a \$63.5 million disallowance, Staff submitted additional recommendations to the Commission. Staff recommends that an internal Commission team should informally explore which financial hedging costs, gains or losses should be considered an allowable expense in future similar cases and to develop a slate of general gas supply review policy guidelines for Commission consideration. Staff recommends that “the Commission request the company present its information in a more conventional manner (using standard presentation tools) in the next gas cost review, if another review is required.”⁴⁴ Staff recommends the “Commission acknowledge for Atmos that the establishment of an earlier, rather than later, firm deadline for plan approval is preferable to the ‘late spring or early summer’ target.”⁴⁵ Finally, Staff “recommends the Commission acknowledge for Atmos that the establishment of firm deadlines, by region, for accumulating stored gas for winter is preferable to a single, unknown ‘beginning of winter’ target.”⁴⁶

8. Examiners’ Analysis

Compliance With Requirements of GUD Nos. 8664 and 9400

⁴² See, Initial Brief of State of Texas and Reply Brief of the State of Texas.

⁴³ See Staff’s Post Hearing Brief at 5.

⁴⁴ See Staff’s Post Hearing Brief at 1 – 2.

⁴⁵ *Id.* at 2.

⁴⁶ *Id.* at 2.

Ms. Myers testified that Atmos has complied with the data requirements by Schedule R.⁴⁷ Mr. Erskine testified that Atmos has complied with all the restrictions imposed on its gas purchasing practices by the final order in GUD No. 8664.⁴⁸ Mr. Nalepa testified that Atmos had fully complied with the requirements of the GUD No. 8664 final order.⁴⁹ The Examiners have not found any evidence that indicates that Atmos has violated any of the gas purchasing restrictions required under the GUD No. 8664 final order. Upon review of the documents filed by Atmos in this proceeding, the Examiners find that Atmos complied with the data and informational requirements of Schedule R imposed by the GUD No. 9400 final order.

The testimony and data submitted in this docket demonstrate that Atmos has not violated any of the transaction restrictions imposed by the GUD No. 8664 final order. The testimony and data submitted in this docket demonstrate that Atmos has complied with the data requirements imposed by Schedule R. Therefore, to the extent that this docket is concerned with reviewing the compliance of Atmos with the restrictions imposed by GUD No. 8664 and the filing requirements imposed by Schedule R, the Examiners find that Atmos has complied with all regulatory requirements imposed by this agency. We recommend that any final order issued in this docket reflect this determination.

Gulf States Standard of Prudence

With regards to whether Atmos' actions were prudent during the review period, the Commission must first establish whether or not Atmos presented contemporaneous documentation of its decision-making process. If Atmos presented sufficient contemporaneous documentation of its decision-making process during the review period, the Commission can review the actual investigations and analyses leading to the utility's gas purchasing decisions.⁵⁰ Thus, the Commission reviews Atmos' actual investigations and analyses that it relied on in making its gas purchases during the review period.

All the intervenors argue that Atmos has not submitted adequate documentation of its gas purchasing decisions during the review period. The State argues that Atmos "eschewed contemporaneous documentation of its gas purchasing decision-making to not lock-in prices and instead attempts to demonstrate prudent decision-making by retrospective analysis."⁵¹ Dallas argues that Atmos failed to produce contemporaneous investigations and/or analyses to justify its decisions and that a retrospective analysis is required.⁵² ACSC argues that Atmos provided no contemporaneous documentation of its decision making.⁵³ Railroad Commission Staff argues that Atmos did not provide sufficient data for the prudence review and intentionally obfuscated the entire hearing process by the manner and content of its presentation of data.⁵⁴ With respect to their

⁴⁷ Atmos Exhibit 1, Myers Direct Testimony at 4-5.

⁴⁸ Atmos Exhibit 4, Erskine Direct Testimony at 23-24.

⁴⁹ ACSC Exhibit 1, Nalepa Direct Testimony at 6 – 7.

⁵⁰ *Gulf States* at 476.

⁵¹ *See*, Initial Brief of the State of Texas at 5, Reply Brief of the State of Texas at 1-3.

⁵² *See*, Initial Brief of the City of Dallas at 4.

⁵³ *See*, Initial Brief of ACSC at 23-24.

⁵⁴ *See*, Staff's Post-Hearing Brief.

requests for reimbursement, the intervenors argue that Atmos failed to document each decision to not lock-in rates during the months of July, August, and September of 2005.

Atmos strenuously denies the allegations of the intervenors regarding the utility's submission of contemporaneous documentation of its decision making for gas purchases made during the review period. Atmos states that it thoroughly documented its actual gas purchases and provided that information to the Commission. Atmos argues that the intervenors arguments are actually complaints that the utility did not document decisions the utility did not make - the intervenors allegations are merely that there is no documentation of Atmos' decisions not to lock-in rates during specific times of the review period. Atmos' position is that its annual planning process was systematic, thorough and well-documented. Atmos argues that the data it submitted in this docket was complete and made consistent with all requirements imposed by the Commission and Staff's prior recommendations.⁵⁵

Gulf States does not mandate the form or amount of documentation required. The case requires sufficient contemporaneous documentation of the decision-making **process**. A "process" can be defined as "a series of actions or operations conducing to an end,"⁵⁶ *i.e.*, a methodology. I think the most reasonable interpretation is that sufficient documentation should be submitted to allow the Commission to review the adequacy and prudence of Atmos' gas purchasing methodology. Because *Gulf States* requires documentation of a process, I do not read this as requiring documentation of each iterative step, *ad infinitum*, which was part of each specific gas purchasing decision (or decision to not lock-in rates) by Atmos during the three year review period. First of all, requiring documentation of each and every iterative step in a decision-making process is a standard that is probably impossible to satisfy, with the probable result being endless arguments of insufficiency by parties in opposition. Second, the *Gulf States* standard contains strong proscriptions against the flawed results obtained from a hindsight analysis. Requiring excessive documentation of each and every iterative step in an overall process will likely result in more hindsight scrutiny of iterative steps. The end result is likely to be that an examination of the prudence and reasonableness of the overall process will be drowned out in a cacophony of meaningless nit-picking about alleged failures that have no direct bearing on whether the decision-making process was prudent. A bad gas purchasing result does not automatically qualify as imprudence under *Gulf States*. Third, the documentation required under *Gulf States* has to be interpreted in light of the ultimate decision that is under scrutiny. Is the decision that is being scrutinized a single decision that is made after a long period of analysis (as were the facts at issue in *Gulf States*) or is it a large number of individual transactions where the period of time to analyze the decision to act is very short? In this case, at issue are numerous transactions over a 36-month period of time. Many decisions were made within a relatively short period of time for investigation and analysis. The documentation required for such decisions should be different from that required where a decision has a longer period of time for investigation and analysis.

In this case the intervenors essentially argue that Atmos should have documented the thought

⁵⁵ See, Reply Brief of Atmos at 9-14.

⁵⁶ Webster's New Collegiate Dictionary, 1977.

processes, conclusions, group analyses, discussions, market conditions, and factors that went into each and every gas purchasing decision (specifically, decisions to not purchase or lock-in prices) that were made by Atmos during the review period. The intervenors' expert witnesses have presented no testimony or evidence (as they essentially have no professional gas purchasing experience or expertise) on the operations of the gas market during the review period, that their proposed level of documentation was utilized by other similarly situated gas utilities, or that this type of documentation process was common industry practice and Atmos should have known of and implemented it during the review period.

The intervenors' alleged documentation deficiency ignores the evidence in the record concerning the realities of the contemporary market for natural gas. The record evidence from Atmos' expert witnesses, and which is common knowledge to the Commission's staff and experts, is that the contemporary gas market is a complex, modern and sophisticated commodity market that is characterized by spot market transactions, short term supply agreements, and pricing based on the commodity price of gas which is typically tied to published indices.⁵⁷ The modern natural gas market is similar to other modern financial markets such as the stock, option or other commodity markets, and is characterized by volatility and unpredictable changes in market direction and trends. Atmos engaged in hundreds of gas purchasing transactions over the review period. The record clearly establishes that many decisions were made during a short time frame as a result of the gas purchasing department's interpretation of changing market conditions and the operational requirements of the gas delivery system. Such a documentation standard advocated by the intervenors is not feasible in light of the operational and market conditions under which these gas purchasing transactions were entered. The level of documentation advocated by the intervenors – that each decision to act, or not act, must be expressly documented by the utility's gas purchasing department – is not feasible and constitutes a regulatory burden that is not addressed by any Commission rule, known case law, and would probably be impossible to satisfy given the modern market for natural gas.

My interpretation that *Gulf States* requires enough detail to examine the overall decision-making process means that documentation of each and every sub-part of an individual decision is not required. The most reasonable interpretation is that the case requires sufficient detail to allow a review of Atmos' gas purchasing process. The Examiners find the allegations of the intervenors that there is no contemporaneous documentation of Atmos' decision making during the review period to be clearly refuted by the substantial evidence submitted by Atmos in this docket. First of all, Atmos submitted all required information and data imposed by GUD Nos. 8664 and 9400. As set forth above, the Schedule R filing requirements are the Commission's data requirements for Atmos during this proceeding and were established at the request of Commission Staff during the highly contested GUD No. 9400.⁵⁸ Atmos has complied with these requirements.

⁵⁷ See, Proposal For Decision and Final Order in Gas Utility Docket No. 9663, *Petition of Enterprise Texas Pipeline, L.P. to Terminate Order in Docket 500*.

⁵⁸ In the two previous gas cost prudence reviews, although both resulted in settlement agreements adopted by the Commission, no additional informational or data requirements have been imposed on Atmos by this agency for the triennial prudence review.

The record evidence contains the testimony of expert witnesses that detail the complex gas planning process as well as the daily purchasing process that Atmos undertakes to obtain necessary gas supplies. The testimony of Dr. Anderson, Mr. Sellars, Mr. Erskine, and Mr. Boerner describes Atmos' gas purchasing practices in depth. The testimony of Atmos' witnesses details the process that the gas purchasing department goes through to actually make purchasing decisions based on the day to day needs of the utility system. The record evidence contains numerous documents and materials that detail the annual gas planning process. The annual gas purchasing plans are well documented and were submitted with supporting witness testimony. All the actual purchasing and contract data has been submitted allowing a review of the actual purchases and which allows Commission staff to review whether the amounts of gas that were purchased were needed and if the prices were market prices. Atmos submitted the following evidence as contemporaneous documentation of its gas purchasing practices during the review period: (1) The written materials of each Annual Gas Supply Plan; (2) Over 3,000 pages of supporting documents for the Annual Plans, including prior winter postmortem reviews, gas demand, forecast, and weather data, test case scenarios, presentations, RFP processes and results, hedging, and storage data; (3) Over 1,000 pages in electronic format, of contemporaneous daily supply plans, prepared three times per day during each gas buying day of the review period; (4) Over 150 pages showing monthly gas purchases by contract; (5) A CD containing approximately 100 files of contemporaneous winter planning worksheets showing price volatility mitigation efforts and progress during the review period; and, (6) Approximately 1,000 pages of gas buyers' contemporaneous daily notes regarding purchases during the review period.⁵⁹ The allegations by the intervenors that the utility did not produce any documentation are overwhelmingly refuted by the record evidence, have no supportable basis in fact and are without merit.

The Examiners find that Atmos submitted sufficient contemporaneous documentation of its decision-making process during the review period and is not required to undertake a retrospective analysis to establish the prudence of its gas purchasing practices during the review period. Thus, Atmos is required to establish that its gas purchase decision-making process was prudent.

The testimony of Atmos' witnesses describes the gas purchasing process utilized by the utility during the review period. The evidence shows that Atmos undertakes an annual planning process every year to develop an annual "Gas Supply Plan." Atmos uses a variety of methods and tools to forecast customer gas needs throughout the year and during the winter heating season. The annual Gas Supply Plan is presented to Atmos management for approval and to Commission Staff for review. After the Gas Supply Plan is finalized then Atmos determines how to implement the plans. The annual Gas Supply Plans set forth an appropriate mix of baseload, peaking and spot purchase contracts. Atmos uses a structured gas acquisition process that uses requests for proposals ("RFPs") or spot-market pricing for the bulk of the supply portfolio. Atmos implements the Gas Supply Plan through a daily planning process and contract administration function. Atmos additionally undergoes a daily planning process that utilizes demand forecasting, weather forecasting and other tools to determine the daily purchase needs of the utility. Atmos also undertakes to mitigate price volatility. The focus is to limit exposure of the gas supply portfolio to the daily spot

⁵⁹ See, Atmos Exhibit 10, Boerner Rebuttal Testimony.

market while still being able participate in the spot market when prices start to decline. During the review period, Atmos sought to mitigate price volatility by attempting to establish a known price for approximately 45% of expected winter season gas supplies. Atmos chose to mitigate price volatility by implementing physical hedges, a process of using gas storage and baseload contract prices to establish in advance of the winter season known prices.

The Examiners find that the record evidence establishes that Atmos' gas purchasing process was prudent. ACSC argued that Atmos did not have sufficient rules and guidelines for developing and implementing the annual Gas Supply Plans. There is no evidence or testimony in the record that shows that the Atmos annual planning process is somehow flawed, inadequate or imprudent. The intervenors' expert witnesses have presented no testimony or evidence that Atmos' annual gas purchasing process is below current industry standards for similarly situated gas utilities and is thus deficient and imprudent. The Examiners were unable to discover any evidence in the form of trade journal articles, case law or other materials that would raise a question as to the adequacy of Atmos' gas planning process and purchasing practices in light of current industry practices and standards. The Examiners find that Atmos submitted sufficient evidence and testimony to establish that its gas purchasing process during the review period was prudent.

Aggregate Gas Purchasing Results

The Gas Utilities Code provides that the Commission shall ensure that each rate a gas utility makes, demands, or receives is just and reasonable.⁶⁰ A gas utility is allowed to recover in its revenues its reasonable and necessary operating expenses.⁶¹ In this proceeding, we are reviewing the aggregate gas purchasing results of Atmos during the review period. Given the legal standard that only expenses that are reasonable and necessary are ultimately recoverable by a gas utility, the appropriate questions on review are (1) whether the gas prices paid by Atmos were reasonable, *i.e.* were they within range of the market price for gas at the time the purchases were made; (2) whether the volumes purchased were necessary; and (3) whether Atmos complied with the gas limitations imposed by GUD No. 8664. As set forth above, the Examiners find that Atmos complied with the purchasing restrictions imposed by GUD No. 8664.

The Examiners found no evidence in the record that Atmos made any gas purchases outside the market price for gas. The gas prices of Atmos' spot, baseload and peaking contracts do not appear to be outside the market price for gas or unreasonable. The intervenors do not allege that Atmos made purchases of gas at above market prices. The following charts compare the price for gas during the review period and various average spot prices for the Katy, Carthage, Wa-ha, and Henry Hubs. Chart A illustrates the premium or discount Atmos' paid for gas over the review period relative to weighted average spot prices during the period. Chart B illustrates Atmos' price paid for gas by month relative to average spot prices. The Examiners find that evidence presented in this docket establishes that the gas purchases made by Atmos during the review period were

⁶⁰ TEX. UTIL. CODE ANN. § 104.003(a) (Vernon 1998 & Supp. 2006).

⁶¹ TEX. UTIL. CODE ANN. § 104.051 (Vernon 1998 & Supp. 2006).

reasonable and therefore constituted an allowable expense under the Gas Utilities Regulatory Act and were ultimately recoverable from Atmos' customers. There is no evidence in the record that Atmos purchased excessive or unreasonable volumes of gas.⁶² The Examiners therefore find that the gas purchases made by Atmos during the review period were reasonable and necessary and therefore prudent.

Failure to Lock-in Prices

The intervenors collectively argue that Atmos was imprudent in its gas buying decisions during the 2005 gas purchasing season. The two intervenor witnesses argue essentially the same thing – that Atmos delayed in locking-in baseload contract prices, such action was imprudent, and as result the customers are entitled to their respective calculated damages. Mr. Pous testifies that Atmos should have started to lock-in baseload contract prices in June of 2005, instead of July (when Atmos began to lock-in prices). Mr. Pous testifies that Atmos “in spite of recognizing the benefits of the early implementation of its Plan, the Company delayed the locking in of gas prices for the upcoming 2005-2006 winter until the peak hurricane season” and “took the unique action, or inaction, of locking in no gas during the month of August.”⁶³ Mr. Nalepa testifies that Atmos should have started to lock-in baseload contract prices in anticipation of the hurricane season and imprudently delayed. He testifies that Atmos' delay in not locking-in prices in June and not following the gas purchasing plans resulted in imprudent gas prices paid by the customers.⁶⁴ Both witnesses allege that Atmos did not follow its gas purchasing plans.

The Examiners find the intervenors' allegation that Atmos did not follow its Annual Gas Supply Plans to be without merit and against the clear weight of the evidence submitted in this docket. First of all, Atmos' witnesses testified that the Annual Supply Plans are “flexible” and that they have no concrete, fixed dates. The plans contain “goals” not rigid deadlines. Second, the intervenors allege that Atmos did not mitigate the percentage of winter supply that it planned to mitigate. The evidence indicates that this charge is without merit and that Atmos achieved all its price volatility mitigation goals during the review period.⁶⁵

Implicit in the Intervenors' collective allegations of imprudence is the assumption that Atmos' gas purchasing plan must have fixed purchase dates from which the utility is not able to vary. Under the intervenors' theory, only fixed purchase plans with finite deadlines are prudent and thus a gas purchasing program that has flexible or discretionary deadlines is imprudent. The standard of prudence as set forth in *Gulf States* (when conducting a retrospective analysis, which we have found is not necessary in this docket) is that the utility manager's choice be one that is within an acceptable range of choices. In effect, for Atmos' purchasing program to be imprudent, it must be established that the program must lie outside this acceptable range.

⁶² There is no evidence of excessive increases in volumes of gas in storage and related costs.

⁶³ Dallas Exhibit 1, Pous Direct Testimony at 24.

⁶⁴ ACSC Exhibit 1, Nalepa Direct Testimony at 1- 23.

⁶⁵ See, Atmos Exhibit 10, Boerner Rebuttal Testimony.

The evidence shows that a significant level of gas market knowledge and experience is inherent in Atmos' gas purchasing decisions. Atmos has a knowledgeable staff of gas purchasers with many years of experience who monitor and respond to the gas market, prices and operational system needs on a daily basis. Complex computer modeling and forecasting of daily system minimum demand underlie daily purchasing decisions. Decisions are based on the knowledge and experience of Atmos' traders and their analysis of current market conditions and the physical needs of the utility system on a real-time daily basis. The flexibility of its gas purchasing process and the need to be able to respond to changing conditions was emphasized by Atmos' witnesses. The gas purchasing plans that Atmos creates do not contain fixed, required dates that must be adhered to. Atmos' purchasing plans have goals but are designed to be flexible and allow the utility to use gas market knowledge and operational needs to make gas purchasing decisions.

There is no evidence that clearly establishes that "fixed deadline" gas purchasing plans only are within the range of acceptable choices to a utility manager. There is no evidence that Atmos' "flexible and discretionary" gas purchasing program lies outside the range of acceptable choices to a utility manager. The intervenors submitted no evidence that the gas purchasing practices of Atmos, whether in the planning stage or in the implementation stage, are outside the range of acceptable purchasing practices employed by similarly situated gas utilities. The Examiners could find no evidence that Atmos' flexible purchasing practices are outside the range of acceptable utility practices.

The Examiners find the evidence establishes that the intervenors' allegations of imprudence are based on impermissible hindsight. The intervenors present no evidence that Atmos' gas purchasing practices are outside the range of current industry standards. Their allegations of imprudence are based solely on when Atmos locked-in rates. Neither Mr. Nalepa or Mr. Pous offer any credible evidence establishing that Atmos should have locked in rates at an earlier time, should have known of such a "seasonal" advantage to lock-in rates earlier, and failed to act in accordance with a known industry practice. Their calculations of damages rest solely on the differences in the market price of gas at different times – not on any allegation of purchases made at prices above the market price. Thus, any alleged imprudence disappears if the market price of gas is higher than at the time when Atmos locked-in rates. The damages models prepared by the intervenors' witnesses were demonstrated at the final hearing to be inherently flawed and biased to show damages.⁶⁶ The damages models contain no specific contract prices, and use price data that is essentially an average of an average. The damages models are not credible evidence of imprudence or evidence that customers are entitled to reimbursement, and can not be reliably used to calculate damages or reimbursement amounts.

Gas Storage Issues

The arguments set forth by Mr. Nalepa regarding Atmos' use of storage gas are essentially that Atmos should have used gas in storage to lower the effective cost of gas charged to customers.

⁶⁶ See, Transcript of Final Hearing Vol.2

No where in Mr. Nalepa's testimony is there any evidence that Atmos' use of gas in storage is outside the range of acceptable practices utilized by prudent utility managers. Mr. Nalepa's testimony does not address the practices of other utilities in this regard. ACSC offered no exhibits, published trade journal articles, documents, treatises, or testimony that addresses the range of choices that utility managers may make with regards to the acceptable use of storage gas when supplying utility customers with gas. Thus, there is no evidence in the record that Atmos' use of storage gas primarily for operational integrity is imprudent under the legal standard set forth in *Gulf States*. Mr. Nalepa's testimony in regards to storage gas is an obvious example of hindsight analysis and is little more than an attempt to justify some amount of monetary refund. There is simply no evidence in the record that a reasonable person can conclude that Atmos' use of storage gas during the review period was outside the range of choices that reasonable and prudent utility managers would make. The Examiners recommend that the Commission find that Atmos' use of storage gas was prudent during the review period and deny any requested compensation requested by ACSC.

9. Rate Case Expenses

ACSC and Dallas request that the Commission require the utility to reimburse their rate case expenses incurred in this docket. Prudence reviews of gas purchase expenditures passed through to ratepayers through purchased gas adjustment (PGA) clauses are not "ratemaking proceedings" and municipalities are not entitled to reimbursement for costs of participating in reviews.⁶⁷ Not all matters that have a potential effect on rates are "ratemaking proceedings" requiring gas utility to reimburse municipality; only matters directly resulting in changed rates constitute ratemaking proceedings.⁶⁸ In determining the reasonableness of the rate case expenses, the Commission shall consider all relevant factors including but not limited to those set out previously, and shall also consider whether the request for a rate change was warranted, whether there was duplication of services or testimony, whether the work was relevant and reasonably necessary to the proceeding, and whether the complexity and expense of the work was commensurate with both the complexity of the issues in the proceeding and the amount of the increase sought as well as the amount of any increase granted.⁶⁹ Given the language of the Court of Appeals ruling on this issue, and given that we found the intervenors' allegations of imprudence to be without merit and largely based on impermissible hindsight analyses, we recommend the Commission deny ACSC and Dallas' request for reimbursement of rate case expenses.

The Examiners recommend that the Railroad Commission of Texas approve the attached Proposed Final Order containing findings of fact and conclusions of law.

Respectfully submitted,

⁶⁷ *CenterPoint Energy Entex v. Railroad Comm'n of Texas*, 208 S.W.3rd 608, 626 (Tex. App. – Austin 2006).

⁶⁸ *CenterPoint Energy Entex v. Railroad Comm'n of Texas*, 208 S.W.3rd 608, 626 (Tex. App. – Austin 2006).

⁶⁹ 16 TEX. ADMIN. CODE §7.5530(b) (2002).

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