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RAILROAD COMMISSION OF TEXAS

OFFICE OF GENERAL COUNSEL

MEMORANDUM

TO: Victor G. Carrillo, Chairman
Elizabeth A. Jones, Commissioner
Michael L. Williams, Commissioner

FROM: John Chakales, Hearings Examiner

DATE: January 6, 2010

SUBJECT: Gas Utilities Docket No. 9869 (consolidated): *Petition for De Novo Review of the Denial of the Statement of Intent Filed by Atmos Energy Corp., Mid-Tex Division by the City of Dallas; Statement of Intent filed by Atmos Energy Corp., Mid-Tex Division to Increase Gas Utility Rates in the Unincorporated Areas Served by the Mid-Tex Division*

The Case Summary and Memorandum submitted in the notebook items stated incorrectly that the Examiners recommend a $23,736,945 revenue increase for Atmos. As a result of the Revised Proposal for Decision and updates to the Examiners' Worksheets, the Examiners recommend that the Commission approve a $14,493,739 revenue increase. A corrected Case Summary and Memorandum are attached.

attachments

VICTOR G. CARRILLO, *CHAIRMAN*
ELIZABETH A. JONES, *COMMISSIONER*
MICHAEL L. WILLIAMS, *COMMISSIONER*

LINDIL C. FOWLER, JR., *GENERAL COUNSEL*
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HEARINGS SECTION

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On November 5, 2008, Atmos Energy Corp., Mid-Tex Division ("Atmos") filed a statement of intent to increase rates within the City of Dallas. On March 25, 2009, the City of Dallas ("Dallas") issued Ordinance 25709, denied Atmos' rate request and reduced Atmos' rates for providing gas service to customers located within Dallas. On April 23, 2009, Atmos timely filed a petition for review of the denial of its statement of intent with the Commission. On April 23, 2009, Atmos filed a Statement of Intent to increase rates for customers located within the unincorporated areas served by the utility. The statement of intent was docketed as GUD No 9870 and was consolidated by the Examiners into GUD No. 9869. The Examiners conducted a final hearing in this matter August 18 - 21, 2009. The Examiners distributed their initial proposal for decision on October 9, 2009. The parties timely filed exceptions and replies. The Examiners subsequently distributed their first revised proposal for decision on December 7, 2009. In the first revised proposal for decision the Examiners made two substantive changes in their recommendations to the Commission regarding billing determinants and storage gas. The Examiners set deadlines for exceptions and replies of December 10 and 14, limited to these two issues.

In its petition for review and subsequent August 4, errata filing, Atmos requests an overall revenue increase of $ 42,509,227 on base rate revenues. In their revised proposal for decision the Examiners recommend an overall revenue increase over current base revenue of $14,493,739.

Atmos filed a letter extending the statutory deadline in this docket until January 29, 2010. On October 28, 2009, Dallas filed a Request for Limited Oral Argument. I have attached these pleadings. The parties may file exceptions and replies limited to the two substantive changes in the Examiners' recommendations. When these are received they will be distributed.

attachments

- First Revised Proposal for Decision
- First Revised Proposed Final Order
- Atmos' Exceptions to the PFD
- Dallas' Exceptions to the PFD
- State's Exceptions to the PFD
- CenterPoint's Exceptions to the PFD
- Atmos' Reply to Exceptions
- Dallas' Reply to Exceptions
- State's Reply to Exceptions
- Dallas' Request for Limited Oral Argument
- Response of Atmos Energy Corporation, Mid-Tex Division to the City of Dallas' Request for Oral Argument
- Exceptions of the State of Texas to the First Revised Proposal for Decision
- Supplemental Exceptions of Atmos Energy Corp., Mid-Tex Division to the 1st Revised Proposal for Decision
- Replies of the State of Texas to Exceptions to the First Revised Proposal for Decision
- City of Dallas' Replies to Supplemental Exception
- Letter to Commissioners Regarding Exceptions to the Revised Proposal for Decision

VICTOR G. CARRILLO, *CHAIRMAN*
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RAILROAD COMMISSION OF TEXAS

OFFICE OF GENERAL COUNSEL

GUD No. 9869

PETITION FOR DE NOVO REVIEW OF THE DENIAL OF THE STATEMENT OF INTENT FILED BY ATMOS ENERGY CORP., MID-TEX DIVISION BY THE CITY OF DALLAS; STATEMENT OF INTENT TO INCREASE GAS UTILITY RATES IN THE UNINCORPORATED AREAS SERVED BY THE MID-TEX DIVISION

APPEARANCES:

Ann M. Coffin William Coe Parsley Coffin Renner LLP 98 San Jacinto Boulevard, Suite 1450 P.O. Box 13366 Austin, Texas 78711	Atmos Energy Corp., Mid-Tex Division ("Atmos")
Norman J. Gordon Mounce, Green, Myers, Safi & Galatzan 100 N. Stanton, Suite 1700 El Paso, Texas 79901-1448	City of Dallas, Texas ("Dallas")
John Pierce Griffin Assistant Director of Appellate Law Railroad Commission of Texas 1701 N. Congress Austin, Texas 78711-2967	Railroad Commission of Texas Staff ("Staff")
Larry C. Buch, Assistant Attorney General Office of the Attorney General P. O. Box 12548 Austin, Texas 78711	State of Texas ("State")

<u>FIRST REVISED PROPOSAL FOR DECISION</u>
<u>PROCEDURAL HISTORY</u>

DATE FILED:	April 23, 2009
HEARING DATE:	August 18 - 20, 2009
HEARD BY:	John Chakales, Hearings Examiner Mark Brock, Technical Examiner Lynne LeMon, Technical Examiner
INITIAL PFD CIRCULATION DATE:	October 9, 2009
STATUTORY DEADLINE:	January 29, 2010

I. INTRODUCTION AND OVERVIEW

On April 23, 2009, Atmos Energy Corp., Mid-Tex Division ("Atmos"), filed a petition for review of the denial of its statement of intent by the City of Dallas, Texas with the Railroad Commission of Texas ("Commission"). The petition for review was docketed as GUD No. 9869. Atmos subsequently filed a statement of intent to change the rates in all environs of its distribution system to match the rates it requests in the appeal filed as a result of the City of Dallas, Texas denying its rate request. The statement of intent was docketed as GUD No 9870 and was consolidated by the Examiners into GUD No. 9869.

The petition for review originally requested overall revenues for the utility's distribution system of $1,748,227,289 (including gas costs), for an overall revenue increase of $47,171,815 on base rate revenues. Atmos filed an August 4, 2009, errata filing which reduced its original request to $1,729,495,319 (including gas costs). This change, combined with an adjustment to the current base revenue calculation, resulted in a proposed increase of $42,509,227.

The City of Dallas, Texas proposed overall revenues for Atmos' distribution system of $ 1,693,509,212 (including gas costs) for an overall revenue decrease of $25,768,116. The State of Texas did not file testimony providing a comprehensive adjustment to the cost of service study provided by Atmos Mid-Tex. Instead, the State of Texas took the position that Atmos Mid-Tex failed to meet its burden of proof on certain issues. Staff of the Railroad Commission actively participated in this docket and made certain recommendations to limit the rate of return on invested capital of the utility and did not submit a comprehensive proposed cost of service study in lieu of Atmos' proposals.

After reviewing the evidence in this proceeding and the briefs filed by the parties, the Examiners find that Atmos has not established that a revenue requirement of $432,206,870 (excluding gas costs) is just and reasonable. The Examiners find that a revenue requirement of $415,704,728 (excluding gas costs) is reasonable. This would result in an overall revenue increase over current base revenue of $23,736,945. The relative positions of the parties are set out in Table 1 below.

Table 1
Relative Position of the Parties (including gas costs)

Party	Base Revenue	Current Revenue	Proposed Increase/Decrease
Atmos Propose Revenue Requirement	$ 1,729,495,319	$ 1,686,986,092	$ 42,509,227
Examiners' Recommendation	$ 1,729,821,184	$ 1,706,084,239	$ 23,736,945
City of Dallas	$ 1,693,509,212	$1,719,277,328	($ 25,768,116)

Included in this filing were proposals to change the utility's Conservation and Energy Efficiency ("CEE") tariff and Rider GCR. The Examiners recommend changes to both of these proposed tariffs.

II. PROCEDURAL HISTORY AND NOTICE

On November 5, 2008, Atmos Energy Corp., Mid-Tex Division ("Atmos") filed a statement of intent to increase rates within the City of Dallas. On March 25, 2009, the City of Dallas ("Dallas") issued Ordinance 25709, denied Atmos' rate request and reduced Atmos' rates for providing gas service to customers located within Dallas. On April 23, 2009, Atmos timely filed a petition for review of the denial of its statement of intent with the Railroad Commission of Texas ("Commission"). Atmos' petition for review filed with this Commission includes a request to reinstate the utility's previous rates for gas service, which were reduced by Dallas in its March 25, 2009, ordinance. On April 23, 2009, Atmos filed with the Commission a Statement of Intent to increase rates for customers located within the unincorporated areas served by the utility, which was docketed as Gas Utilities Docket ("GUD") No. 9870. On May 1, 2009, the Examiners consolidated GUD No. 9870 with this docket. Atmos filed a motion to consolidate GUD No. 9870 into GUD No. 9869. On May 1, 2009, the City of Dallas ("Dallas") intervened in this proceeding. On April 27, 2009, the Staff of the Railroad Commission of Texas ("Staff") intervened in this proceeding. On May 11, 2009, the State of Texas ("State"), by and through the Office of the Attorney General of Texas, Consumer Protection and Public Health Division, Public Agency Representation Section, intervened in this proceeding. No other persons intervened, filed protests or otherwise participated in this docket.

At the July 14, 2009, open meeting the Commission approved an interim order precluding certain issues from further litigation in this docket. At the July 21, 2009, open meeting the Commission approved a second interim order precluding certain issues from further litigation in this docket. On July 17, 2009, all rate case expense issues were severed from this docket into another docket, GUD No. 9901.

Atmos complied with all applicable notice requirements, including those provided in 16 TEX. ADMIN. CODE § 7.235 and TEX. UTIL. CODE ANN. § 104.103 (Vernon 2007 & Supp. 2008). For its customers located in the City of Dallas, Atmos Mid-Tex published notice once each week for four consecutive weeks in newspapers of general circulation in each county in which Atmos Energy Corporation provides gas service. Generally, that notice was published once a week for four consecutive weeks beginning November 11, 2008 and ending the week of December 1, 2008. For customers located in the environs, Atmos provided notice by means of a bill insert beginning on May 22, 2009 and ending on June 19, 2009. The procedural schedule was established on May 12, 2009. The Notice of Hearing was issued on August 4, 2009.

III. JURISDICTION

The Commission has jurisdiction over Atmos Mid-Tex and over the matters at issue in this proceeding pursuant to TEX. UTIL. CODE ANN. §§ 102.001, 103.003,103.051, 104.001, 121.051, 121.052 and 121.151 (Vernon 2007 & Supp. 2008). The Commission is vested with the authority and power to ensure compliance with the obligations of the Gas Utility Regulatory Act and to establish and regulate rates of gas utilities.[1] Gas utilities are affected with a public interest, are monopolies, and are therefore subject to the jurisdiction, control, and regulation of the Commission.[2]

The statutes and rules applicable to this proceeding included, but were not limited to, all sections of TEX. UTIL. CODE CHAPTERS 101, 102, 103, 104, and 121; and all Commission rules in 16 TEX. ADMIN. CODE, Chapters 1, 7, and 8; and 16 TEX. ADMIN. CODE §3.70 (2003).

The Commission has exclusive original jurisdiction over the rates and services of a gas utility that distributes natural gas in areas outside a municipality and distributes natural gas in areas inside a municipality that surrenders its jurisdiction to the Commission. The Commission also has exclusive original jurisdiction over the rates and services of a gas utility that transmits, transports, delivers, or sells natural gas to a gas utility that distributes the gas to the public.[3] More specifically, the Commission has exclusive original jurisdiction over the Company's statement of intent filed at the Commission, the schedule of rates and services to be charged to customers that are served by the Applicant, the schedule of rates and services to be charged to all environs customers served by the Applicant, and the schedule of rates and services to be charged to customers located in any municipality located in the distribution system.

The Commission has exclusive appellate jurisdiction to review an order or ordinance of a municipality exercising exclusive original jurisdiction regarding a statement of intent.[4] As noted above, Atmos Mid-Tex appealed to the Commission the decision of the governing body of Dallas regarding the Applicant's statement of intent.

IV. ISSUES ADDRESSED IN INTERIM ORDERS

The Commission precluded several issues from further litigation in the final hearing of this docket in two separate interim orders approved by the Commission in open conference meetings. The following issues were precluded from further litigation at the Commission's July 14, 2009, open conference meeting:

1. System-Wide Rates: Rates developed for the Mid-Tex Division are determined on a system-wide basis.
2. Materials and Supplies: Use of a thirteen month time period for the calculation of materials, supplies, and prepayments for purposes of the test year analysis.
3. Federal Income Tax Factor: The income tax factor is based on the statutory income tax rate of 35 percent, and the taxable component of return is computed by subtracting interest expense (determined as the product of rate base times the weighted cost of debt) from return on investment.
4. Cost Allocation: The use of a 2-inch pipe minimum distribution system analysis to allocate

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[1] TEXAS UTILITY CODE ANN. §101.002 (Vernon 2007 & Supp. 2008).
[2] TEXAS UTILITY CODE ANN. §§101.002, 121.051(Vernon 2007 & Supp. 2008)
[3] TEXAS UTILITY CODE ANN. §102.001(a) (Vernon 2007 & Supp. 2008).
[4] TEXAS UTILITY CODE ANN. §102.001 (Vernon 2007 & Supp. 2008).

certain components of rate base was approved.

5. Affiliate Transactions: That the provisions of the Gas Utility Regulatory Act governing affiliate transactions do not apply to intracompany allocations or transactions.
6. Gas Cost: To exclude all issues related to the prudence of Atmos' gas purchases.

The following issues were precluded from further litigation at the Commission's July 21, 2009, open conference meeting:

7. Rate Design Methodology, Cost of service Methodolgy and Allocation: Use of the same rate design methodology, class cost of service study methodology and class cost allocation methodology approved by the Commission in GUD No. 9762. To continue to use the same methodology for normalizing volumes in the billing determinants study for weather as approved in GUD No. 9762.
8. Capital Structure: Continued use of actual capital structure and elimination of short term debt from the capital structure.
9. Shared Services: To include and exclude the same shared service categories in cost of service as approved in GUD No. 9762.
10. Uncollectible Expenses: To use a three-year average to calculate the appropriate level of uncollectible expense as approved in GUD No. 9762.
11. Lead-Lag Study: To use the one-day billing lag in the lead-lag study as approved in GUD No. 9762. To include prepayments as an "other rate base" item in the lead-lag study as required in GUD No. 9762.

V. RATE BASE

Atmos requested rate base totals $1,287,824,900, as adjusted for known and measurable changes.[5] The proposed rate base consists of net plant in service through March 31, 2009, in the amount of $1,430,703,337, which excludes the investment in Poly 1 pipe.[6] The primary issues involving Atmos' requested rate base are the post test year adjustments, cash working capital, and accumulated deferred income taxes.

A. Poly 1 Pipe Replacement Expense

During the hearing, questions were asked of Atmos' Witness Mr. Jeffrey S. Knights regarding the replacement of Poly 1 pipe. The original cost and accumulated depreciation attributed to Poly 1 pipe was specifically removed from rate base in GUD Nos. 9400, 9670 and 9762. Mr. Knights acknowledged that Atmos, as part of its continued vigilance, found and removed pieces of Poly 1 pipe.[7] Mr. Knights acknowledged that there might be projects included in this filing that included the replacement of Poly 1 pipe and, upon request by the Examiners, would confirm the

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[5] Atmos Ex. 3, (August 4, 2009 Errata), Schedule B.
[6] *Id.*, Schedule B.
[7] Transcript Volume 3 231:22-24.

expense included in this filing.[8] Mr. Knights did confirm the inclusion of projects that were related to Poly 1 pipe expense in this case. Mr. Knights was able to confirm that approximately 20 projects between July 2007 through March 2009 involved Poly 1 pipe in some manner. There were 14 service line projects and 6 mains projects. The total amount Atmos reasons attributable to Poly 1 included in this filing from those 20 projects is $59,838.[9] Atmos is voluntarily removing these projects from rate base.[10] However, it has not been removed from utility plant in service.

Examiners' Analysis and Recommendation

The Examiners recommend acceptance of Atmos' voluntary removal and reduction to rate base in the amount of $59,838.

B. Post Test Year Adjustments

Atmos proposed certain post test year adjustments which have been challenged by intervenors in this proceeding. Mr. Petersen testified in regards to Atmos' proposed adjustments to rate base.[11] Atmos adjusted amounts for gross plant and accumulated depreciation post test year, through March 31, 2009. Atmos also proposed to reflect actual accumulated deferred income tax ("ADIT") amounts through March 31, 2009.[12] Atmos proposes these adjustments as known and measurable changes to the test year data.

Dallas challenged Atmos' proposed rate base adjustments. Mr. Pous testified that Atmos' test year is the 12 months ended June 30, 2008, and that Atmos has proposed to adjust only part of its cost of service on a projected basis through March 31, 2009.[13] He testified that Atmos adjusted gross plant and accumulated depreciation through March 31, 2009, yet only adjusted accumulated deferred income tax through December 31, 2008.[14] This results in a higher revenue requirement had Atmos used a consistent date for the post test year adjustments.[15] He testified that the use of inconsistent time frames goes beyond the known and measurable standard allowed under TEX. UTIL. CODE ANN. §103.055(a) (Vernon 2007 & Supp. 2008). "In my experience, the concept of a 'test year' is to reflect a matching of revenues, expenses and investment so that an adjustment, even if known and measurable, should not be permitted unless all attendant impacts are taken into account."[16] Mr. Pous testified that Atmos does not need post test year adjustments due to the GRIP provisions which allow the utility to recover new investments via a tariff mechanism. He testified that all post test year adjustments be rejected and that all plant balances and other rate components

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[8] Transcript Volume 3 232:6-17.
[9] Transcript Volume 4 155:6-12.
[10] Transcript Volume 4 155:13-16.
[11] Atmos Ex. 15, Petersen Rebuttal at 3-6.
[12] *Id.* at 3.
[13] Dallas Ex. 4, Pous Direct, p. 9
[14] *Id.* at 9.
[15] *Id.* at 10.
[16] *Id.* at 10.

as of June 30, 2008 be used for setting rates.[17] Mr. Pous alternatively proposes that the Commission allow post test year adjustments through December 31, 2008.[18] The impact of his recommendation to disallow all post test year adjustments results in an $85,422,277 reduction to rate base and a $16,596,872 reduction to allowable revenues. The impact of allowing post test year adjustments to December 31, 2008, results in a $22,557,729 reduction to rate base and a $4,567,278 reduction to allowable revenues.[19]

Mr. Petersen testified that Atmos' known and measurable changes to gross plant, accumulated depreciation, and ADIT were made through March 31, 2009, and do match. Mr. Petersen testified that Atmos agrees with Dallas' contention that it is appropriate to match the timing of ADIT with the timing of net plant and that Atmos provided continuous updates to ADIT balances up to and including the March 31, 2009 balances.[20] He testified that the adjustments are known and measurable and that the updated March 31, 2009 balances are actual balances as of that date.[21] Mr. Smith testified Atmos' proposed known and measurable adjustments satisfy §103.055(a) and previous adjustments approved by the Commission.[22] Mr. Smith testified that there is no requirement that "any adjustment for known and measurable changes must result in an exact matching of revenue, rate base and expense."[23] He testified that the theory advanced by Mr. Pous is that no known and measurable adjustments could be made "since such adjustments would never result in an exact matching of revenues, rate base and expense."[24]

Examiners' Analysis and Recommendation

The evidence and testimony in this docket establish that Atmos made adjustments to gross plant, accumulated depreciation, and ADIT through March 31, 2009. The testimony filed and introduced during the final hearing establish as that these are actual balances for these accounts through March 31, 2009. The gas utility code allows for test year data to be adjusted for "known changes and conditions that are measurable with reasonable accuracy."[25] Adjusting the test year data with the actual balances is a known change that is measurable with reasonable accuracy.

An issue raised by Mr. Pous is whether or not these rate base items may be adjusted without adjusting other revenues and expenses. Atmos' witness points out that the Commission has never required uniform matching of all accounts. The Commission has historically not interpreted §103.055(a) as requiring such treatment. Atmos' witness testifies that such a treatment will prevent adjustments because not every account may be adjusted for known and measurable changes with

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[17] *Id.* at 13.
[18] *Id.* at 13-14.
[19] *Id.* at 13-14.
[20] Atmos Ex. 15, Petersen Rebuttal at 4.
[21] Atmos Ex. 15, Petersen Rebuttal at 5.
[22] Atmos Ex. 13, Smith Rebuttal at 23-24.
[23] Atmos Ex. 13, Smith Rebuttal at 23.
[24] Atmos Ex. 13, Smith Rebuttal at 24.
[25] TEX. UTIL. CODE ANN. §103.055(a) (Vernon 2007 & Supp. 2008)

reasonable accuracy.

A corresponding policy issue involves the inclusion of the most recent additions to net plant in base rates or the utility's reliance on GRIP filings to recover interim investments. In this docket there has been no evidence, testimony, or allegation that the interim investments in plant (and accumulated depreciation amounts and ADIT as well) are not used and useful in providing gas service to the public. Thus, under the Commission's rule these investments are presumed reasonable and Atmos is entitled to earn a return on its investment.[26] One question is whether or not it's the Commission's policy that interim investment to net plant be recovered in base rates or be recovered through the GRIP mechanism of §104.301.[27] Another corollary issue concerns Atmos making its errata filing after discovery had been concluded and approximately two weeks prior to the final hearing in this docket. The timing of the filing substantially effected the ability of the Commission, Examiners and Intervenors to timely scrutinize the errata data and the effects thereof.

The following illustrates the timing issues related to Atmos' errata filing.

Adjustments to Test Year for "Known and Measurable":	March 31, 2009
Errata Adjustments to Test Year:	March 31, 2009
Date Statement of intent Filed:	April 23, 2009
Test Year of Statement of Intent:	June 30, 2008
Discovery Ends:	June 30, 2009
Intervenor Testimony Due:	July 14, 2009
Staff Testimony Due:	July 24, 2009
Rebuttal Testimony Due and Errata Filed:	August 4, 2009
Hearing on the Merits:	August 18-20, 2009

The errata filed on August 4, 2009, replaced estimated, budgeted, and forecasted amounts with actual data from the company's books and records. The errata brought known and measurable changes through March 31, 2009 for net plant, accumulated depreciation and ADIT. Atmos' position is quoted, "In this case, Atmos simply asks that the Commission follow its standard rate setting practice to establish new rates for Dallas and the unincorporated areas of the Mid-Tex Division."[28] Atmos filed its initial filing using estimates and budgeted amounts, a practice the Commission has historically rejected and a basis the Commission has not used to approved rates. The Commission has made it a point to deny the use of estimates and budgeted amounts in past cases.[29] A filing made with budgeted and forecasted amounts, regardless of the accuracy, is unauditable because it has no evidence of actual expenditure, only what a company would target for an expenditure.

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[26] TEX. ADMIN. CODE §7.503 (2002).
[27] TEX. UTIL. CODE ANN. §104.301 (Vernon 2007 & Supp. 2008)
[28] Atmos Reply Brief page 1.
[29] GUD No. 9670 FOFs 172, 180, 181.

It is clear to the Examiners that filing the errata some 35 days after the discovery period ended denied the Examiners and the intervenors the opportunity to conduct discovery on the changes made by Atmos or the additional projects included in this filing. It is also clear to the Examiners that there is a mix-match of periods included in the errata filing. While the Examiners do not find fault with making known and measurable changes to the test year-end, pushing the envelope past the point that rate setting could be skewed by failing to bring all factors to the same period is a problem. Atmos added more than 1,200 projects to be reviewed in its errata filing, totaling an addition of approximately $33 million to its capital investment.[30] During the hearing it was discovered that Atmos' initial filing on April 23, 2009 used a mix of actual amounts and estimates.[31]

The post test year additions to rate base may be recovered in a subsequent GRIP filing. In general, the Examiners opinion is that the better policy is to allow the post test year adjustments to rate base in order have these additions recovered in base rates as opposed to any subsequent GRIP tariff filing, if there is ample time and opportunity for regulatory scrutiny by the Examiners and the Intervenors. However, the timing of the errata filing and the data presented affect this issue.

The Examiners find it unreasonable for Atmos to make a filing knowing it included estimates and budgeted amounts. The Examiners find it unreasonable for Atmos to file an errata that did not just correct errors but replaced many of the amounts in the schedules. The Examiners find it unreasonable to file the errata after discovery, after intervenor testimony and after Staff testimony was filed. The Examiners find it unreasonable for Atmos to include 1,200 new projects in the August 4, 2009, errata filing.

Therefore, the Examiners recommend the removal of the January through March 2009 plant additions of $32,792,028 for Mid-Tex and $268,610 for SSU for a total removal of $33,060,638 from plant in service. Further, the Examiners recommend Atmos be prohibited from making a filing in the future that builds its rate base, cost of service or any components in the filing based on budgeted amounts, forecasts, projections or estimates. The Examiners recommend that all future filings match periods of rate base, revenue, and expenses to the test year-end, to the greatest extent possible. All filings made at the Commission should be based on test year-end actual amounts tied to its books and records, adjusted for actual known and measurable adjustments. Any errata filing should only correct errors and should be done prior to the intervenor testimony due date. A net increase when removing the accumulated depreciation and the affect to ADIT to match the removal of the plant is $819,973.

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[30] Exhibit JSK-R-2 Knights Rebuttal Testimony.

[31] Volume 2 Transcript, pages 6-8.

C. Cash Working Capital

1. Overview

Cash working capital is the capital investment in addition to other rate base items that is required to bridge the gap between when cash is paid for expenses necessary to provide service and when cash is received from customers for that service.[32] Cash working capital represents an amount of cash that a utility must have available to meet current obligations as they arise, due to the time lag between payment of expenses and collection of revenues.[33] The need for working cash has long been recognized by regulatory bodies and the courts.[34] An allowance of cash working capital, however, is not guaranteed as a matter of course and the utility carries the burden of establishing the need for cash working capital.[35] Atmos prepared a lead-lag study to determine the cash working capital needs of the Atmos Mid-Tex system.[36] A lead-lag study empirically identifies the difference in timing between outward cash flow for labor, materials and supplies, inventory, and other expenses, and inward cash flow of revenue from payments to customers.[37]

Cash working capital requirements may be positive or negative. Positive working capital is investor-supplied. In contrast, negative working capital reduces the need for investor-supplied capital and arises when the utility receives customer payments before service is rendered, or when it receives funds before it must satisfy a corresponding liability. To illustrate the concept of cash working capital, if one assumed that the utility paid for natural gas before it supplied the natural gas to the consumer, then the utility would be using positive cash working capital, i.e., money from its investors, to pay for natural gas until the consumer paid the utility. In that case, the investors have an expectation of receiving a reasonable return on its investment. If, however, the consumer paid the utility in advance for use of the product, the company has negative cash working capital and the investor would have no expectation of return because the investor's capital was not being used.[38]

The CWC component feeds in directly to the calculation of rate base. Atmos initially requested a Cash Working Capital adjustment to rate base of ($31,935,075). After making several adjustments subsequent to its Petition for De Novo Review and Statement of Intent as originally

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[32] Atmos Exhibit 8, Petersen Direct at 9.

[33] *Alabama-Tennessee Natural Gas Co. v. Federal Power Commission*, 203 F.2d 494, 498 (3rd Cir. 1953); *People's Counsel v. Public Service Commission*, 399 A.2d 43, 46 (D.C. Cir. 1979).

[34] *Smyth v. Ames*, 169 U.S. 466 - 418 (1898).

[35] *Southern Union Gas Co. v. Railroad Commission of Texas*, 701 S.W.2d 277 (Tex. App. — Austin 1986 (Gas utility failed in its burden of proof regarding its working capital needs); *Peoples Counsel v. Public Serv. Comm'n*, 399 A.2d 43, 45.

[36] *See*, Atmos Exhibit Nos. 8 (Petersen Direct Testimony), 15 (Petersen Rebuttal Testimony), and 15A (Petersen August 4, 2009, Cash Working Capital Study Errata).

[37] *Colorado Municipal league v. Public Util. Comm'n*, 687 PR 2d, 416, 420; *Cent. La. Elec. Co. Inc. v. La. Publ. Serv. Comm'n*, 373 So.2d 123, 130 (La. 1979).

[38] *Zia Natural gas Company v. New Mexico Public Utility Commission*, et al., 2000 WL 358390 (March 1, 2000).

filed, Atmos filed an August 4, 2009, Errata in which the utility requested a cash working capital adjustment to rate base of ($33,017,661).[39] The overall impact of Atmos' requested CWC study is a $4,332,240 decrease in the utility's revenues. The City of Dallas opposes the cash working capital request of Atmos Mid-Tex.

2. Collection Lag

Collection lag is the average number of days between issuing a bill and receiving payment.[40] Mr. Petersen testified that his calculation of Atmos' collection lag "followed the Commission's stated preference in GUD No. 9762 for calculating collection lags based on billing samples."[41] All test year billings from a sample of 100 residential, 100 commercial and 50 industrial and transportation customers were used to calculate a weighted average collection lag of 18.03 days. Mr. Petersen verified this by a comparison with the average amount of time that amounts owed by customers remained on Atmos' books as accounts receivable. He testified that the period of time is 19.39 days and that the 18.03 day collection lag is conservative. Atmos proposes that the collection lag be set at 17.95 days.[42] The City of Dallas proposes that the collection lag should be maintained at 16.65 days, which is the existing value as approved in GUD No. 9762.[43] The impact of the proposed adjustment is to reduce the revenue requirement by approximately $630,608.

Mr. Pous testified on behalf of the City of Dallas that there are several problems with Atmos' collection lag calculations.[44] Mr. Pous testified that Atmos made an error in the calculation of revenue collection days for the industrial and transportation class customers. For the residential class customers, elimination of two outliers reduces Atmos' proposed 18.69 revenue collection lag days to 16.65. He also testified that two outliers from both the commercial class sample and the industrial class sample is required. He testified that removing these outliers results in a collection lag period of 17.10 days.[45]

Mr. Petersen testified that Mr. Pous' recommendation to remove outliers is not supported by the actual behavior of Atmos' customers. Mr. Petersen testified on rebuttal that Mr. Pous's proposal to remove certain outliers is based upon the premise that the collection lag is normally distributed. He submitted two exhibits that demonstrate that the distribution is skewed and not normally distributed.[46]

Examiners' Analysis and Recommendation

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39 Atmos Ex. 15A, Petersen August 4, 2009, Cash Working Capital Study Errata.
40 Atmos Ex. 8, Petersen Direct, p. 13.
41 *Id.* at p. 13.
42 Atmos Ex. 8, Petersen Rebuttal, p. 11.
43 Dallas Ex. 4, Pous Direct, p. 19.
44 *Id.* at 17-19.
45 *Id.* at 17-19.
46 Atmos Ex. 14, Petersen Rebuttal, THP-R-2, THP-R-3, and pp. 7-12.

The Examiners find that Atmos' calculation of collection lag is consistent with the collection lag calculation approved in GUD No. 9762. Mr. Petersen's exhibits on rebuttal are persuasive evidence that the collections are not normally distributed and that the weighted average sampling proposed by the utility is a reasonable method for determining collection lag. The evidence shows that slow-paying "outliers" do exist and it is reasonable for statistical purposes to include them in the sample used. Mr. Petersen's evidence on rebuttal shows that the customer samples are conservative estimates and do not overstate the collection lag. The Examiners recommend that the Commission approve Atmos' proposed collection lag period of 17.95 days.

3. Banking Lag

The bank lag is the lag between receiving payment and having funds available to draw at the bank.[47] Atmos proposes using a one-day banking lag in this proceeding. The Commission approved a one-day banking lag in GUD No. 9762. In its July 21, 2009, Interim Order, the Commission found that the use of a one-day banking lag in Atmos' lead-lag study, as approved in GUD No. 9762, is reasonable for use in this docket. In its July 21, 2009, Interim Order the Commission ordered that the use of the one-day banking lag by Atmos is precluded from further litigation in this docket. The Examiners do not recommend that the Commission change its prior determination of this issue.

4. Gas Cost Expense Lag

Atmos proposes a purchased gas cost lag of 42.02 days. Dallas proposes adjustments to Atmos' gas cost expense lag component of the lead/lag study. Mr. Pous testifies that Atmos "has erroneously included a value that assumes a check was written and cashed not only before the invoice was received, but even prior to the acceptance of all the gas during a given month."[48] He recommends replacing the check float associated with gas purchases with a 2-day float, which increases the check clearing lag from 7.38 days to 7.63 days. Mr. Pous also testifies that Atmos cannot demonstrate that it is reasonable to pay early for gas cost "as such activities demonstrate inefficient cash management practice."[49] Mr. Pous also recommends that payments occurring prior to a contractual due date be extended to reflect payment on the last day permitted by contract. He recommends increasing the overall gas cost expense lead day level from 41.03 days to 42.59 days. The impact of the proposed adjustment is to reduce the revenue requirement by approximately $374,116 using 41.03 days.

Mr. Petersen testified that Mr. Pous incorrectly calculated the check clearing date.[50] He testified that Mr. Pous doesn't indicate how his proposed check clearing calculation is made. Mr. Petersen testified that the correction of an identified error does not change the lag before check

[47] Atmos Ex. 8, Petersen Direct, p. 14.
[48] Dallas Ex. 4, Pous Direct at p. 20.
[49] Dallas Ex. 4, Pous Direct at p. 21.
[50] Atmos Ex. 15, Petersen Rebuttal at pp. 13-14.

clearing, and that the correction increases purchased gas cost lag from 41.99 days to 42.02 days.[51] Mr. Petersen also testified that Mr. Pous' recommendation to extend the actual gas cost payment dates ignores the actual pattern of the company which is to pay at or close to the last day available with variations in both directions.[52]

Examiners' Analysis and Recommendation

The August 4, 2009, errata filing made by the utility increases the company's gas cost lag to 42.02 days, which is extremely close to the 42.03 days originally recommended by Mr. Pous. In Dallas' second errata filing Mr. Pous recommended the 42.59 day purchased gas expense lag. The Examiners find that Mr. Pous' recommendation to extend payments to the last day under contract to be not reflective of Atmos payment practices in the sample data. There is no compelling evidence or reason to extend the gas payment dates because this does not recognize that some payments are made prior to the last payment day under contract. The Examiner's recommend that the Commission approve the gas cost expense lag at 42.02 days for purposes of determining the utility's CWC.

5. Labor Expense Lag

Atmos proposes a total labor expense lag of 24.64 days.[53] The labor lag is composed of four components: employees with direct deposit, employees who receive checks, paid time off (PTO), and incentive pay. Mr. Pous testified that he found it necessary to make three adjustments to Atmos' PTO component of the labor expense lag. Mr. Pous testified that Atmos' mid-month assumption is inappropriate for December and proposes adjusting the December PTO by one week.[54] Mr. Pous also testified that Atmos understated the level of prior year PTO carryover associated with the test year. He proposes that the test year amount of PTO not taken during the test year plus the carryover from the prior year is the effective carryover during the year at issue and the correct amount is $51,706.[55] Mr. Pous testified that Atmos failed to recognize that PTO is taken during a normal two-week pay period and proposes adjusting this by seven days.[56] The impact of the proposed adjustment is to reduce the revenue requirement by approximately $45,427.

Mr. Petersen testified that PTO is taken on a calendar year basis, that it is accrued uniformly throughout the year, and that the average date PTO is accrued is the mid-point of the year during the beginning of July. He testified that an additional payment lag is not necessary as such a lag is captured in the data because payment is delayed seven days.[57] Mr. Petersen testified that Mr. Pous' assumption that PTO is taken on the 22nd of the month is faulty because it is based on the month of December and does not take into account employees taking PTO around the July 4th holiday or after

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[51] *Id.* at 13-14.
[52] *Id.* at p. 15.
[53] Atmos Ex. 8, Petersen Direct at 15.
[54] Dallas Ex. 4 at 22.
[55] *Id.*
[56] *Id.* at
[57] Atmos Ex. 15, Petersen Rebuttal at 17.

the first of a new year.[58] He testified that Mr. Pous' calculation of PTO yearly carryover overstates this amount because it ignores the five day limit on amount of PTO an employee may carryover into the next year.[59]

Examiners' Analysis and Recommendation

The Examiners find that the evidence establishes that Dallas' proposed adjustments to PTO are not needed to adjust the labor expense component of Atmos' lead/lag study. Mr. Petersen's rebuttal testimony establishes that the payment lag is captured in the data and therefore Dallas' proposed 7-day adjustment is not needed. Dallas' proposed carryover adjustment does not take into account the 5-day limit on carrying over accrued PTO and should not be approved by the Commission as it is not reflective of the utility's policies. The Examiners recognize that it is reasonable to adjust December to assume that is taken on average on December 22. The problem with Dallas' proposal is that it focuses on only one month. If December is adjusted then other months should be adjusted as well. Atmos proposes using the 15th of each month. The Examiners find that method reasonable. The Examiners find that it would also be reasonable to adjust all months in which PTO is typically used correspondingly, however Dallas does not recommend that. Absent making adjustments for each month based on typical consumption of PTO for that given month, the Examiners would recommend using the midpoint for all 12-months as proposed by Atmos.

6. O&M Non-Labor Expense Lag

Mr. Petersen testified that the O&M non-labor expense lag measures the lag between the date services were provided to Atmos and the date Atmos paid the bill for those services.[60] Mr. Petersen testified that his calculation of 29.41 days is consistent with that approved in GUD No. 9762. He originally calculated a total average lag for O&M non-labor expense of 26.82 days.[61] Dallas witness Mr. Pous testified that he found numerous problems with the O&M non-labor expense lag component of Atmos' lead/lag study. Mr. Pous testified that it is an error to include prepayments to vendors prior to receiving an invoice. He testified that there are approximately 100 invoices with negative lead days or prepayments;[62] that the sample includes the impact of inappropriate charges such as charges for limousine services and contributions.[63] He testified that Atmos inappropriately includes capital costs in the sample, and that the inclusion of an entire payment when a portion of the payment is capitalized is inappropriate.[64] He testified that there is an inconsistent application of service period and Atmos relies on the invoice date without identifying the service period.[65] Mr.

58 *Id.* at 17.
59 *Id.* at 18.
60 Atmos Ex. 15, Petersen Rebuttal at 19.
61 Atmos Ex. 8, Petersen Direct at 17.
62 Dallas Ex. 4, Pous Direct at 24.
63 *Id.* at 24.
64 *Id.* at 25.
65 *Id.* at 25.

Pous recommends that the Commission use the 34.62 expense lead day calculation approved in GUD No. 9762 because of the errors he found in this component of Atmos' lead/lag study.[66] The impact of his recommendation is to reduce rate base by $2,154,290.[67] The impact of the proposed adjustment is to reduce the revenue requirement by approximately $181,636.

Mr. Petersen eliminated all invoices with negative lag days which changed the non-labor O&M lag to 29.41 days.[68] He testified that it is not improper to include amounts not recoverable by Atmos in its cost of service because the study accurately reflects the payment practices regardless of whether an expense is ultimately recoverable for rate-making purposes.[69] He testified that only the portion of an expense that is recoverable as an expense is included in the sample.[70]

Examiners' Analysis and Recommendation

One issue raised is whether or not including non-recoverable expenses in this component of the lead/lag study is appropriate. There is no allegation that an inappropriate expense is being sought for recovery by means of this study. Mr. Petersen's testimony is essentially that the payment practices of the company exist regardless of the ability to recover that particular expense under rate-making principles. Mr. Pous recommends discarding Mr. Petersen's calculation. We find Mr. Petersen's rebuttal testimony persuasive. He adjusted the value by removing negative lag days. The argument that the utility's payment practices are the same regardless of the recoverability of a particular expense in rates is logical and reasonable. Mr. Petersen addressed each one of Mr. Pous' alleged problems with this particular calculation. We find Atmos' O&M lag of 29.41 days to be reasonable.

7. Local Gross Receipts Tax / Franchise Fee Expense Lag

Mr. Petersen calculated the lag on franchise fees paid at 95 days. He testified that for this docket he reviewed all franchise agreements and treated only those which contained language stating that both parties agreed that the payment was for the period in which the payment was made.[71] Franchise payments made pursuant to agreements without such language were treated as being paid in arrears. Dallas objects to Atmos' review and treatment of franchise agreements with prepayment contract language. Mr. Pous testified that Atmos has made an "artificial and inappropriate reduction from the actual $70,778,540 of local gross receipts fees to only $31,451,629."[72] He recommends "retaining the full expense level as the appropriate amount to be utilized for CWC calculation purposes in this proceeding, as was the case in GUD No. 9762."[73] Mr. Pous does not appear to

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66 *Id.* at 25.
67 *Id.* at 26.
68 Atmos Ex. 15, Petersen Rebuttal at 20.
69 *Id.* at 21.
70 *Id.* at 22-22.
71 Atmos Ex. 8, Petersen Direct at p. 19.
72 Dallas Ex. 4, Pous Direct at p. 28.
73 *Id.* at 29.

object to Atmos' initial proposed lag of 95 days. In Atmos' rebuttal, the lag was changed to 95.87 days. The local gross receipts fee was also changed to $32,443,351.[74] The impact of Dallas' recommendation is to lower CWC by $6,438,839 and reduce the revenue requirement by $706,645.[75]

Examiners' Analysis and Recommendation

The evidence in the record indicates that Atmos' proposed gross receipts tax expense lag calculations and proposal is reasonable. The evidence shows Mr. Petersen reviewed the new franchise fee agreements for clear language indicating which fees would be prepaid or paid in arrears. Dallas' proposal is to remove all amounts determined to be prepaid. Because the evidence shows that the determination of which franchise fees are prepaid, it is reasonable to use such information in calculating a more accurate gross receipts tax expense lag. There is no credible reason to disregard the actual prepaid amounts when determining this component of the utility's lead/lag study. The Examiners recommend that the Commission approve Atmos' proposed gross receipts tax expense lag of 95 days and gross receipts fees of $31,459,629.

D. Prepayments of Gross Receipts Taxes

The evidence indicates that Atmos made an appropriate adjustment to prepayments related to local gross receipts taxes. Mr. Petersen testified that the "correct amount of the prepayment adjustment has already been made by the Company to reflect a thirteen month average and to remove prepaid amounts on the books associated with franchises that did not include the type of language that I insisted on in order to treat the franchise as prepaid. As a result of the Company's adjustment, the amount of local gross receipts tax prepayments that are included in the Company's rate filing is $4,875,708."[76] No further adjustment is therefore necessary. The Examiners recommend $4,875,708 of local gross receipts prepayments be recognized.

E. Shared Services Unit ("SSU") Projects

The City of Dallas has recommended removal of two projects that Dallas says are related to the New Orleans plant. These two projects, Nos. 010.11352 and 010.11353, are shared services unit projects that include information technology and leasehold improvements, including the installation of a shower. The City of Dallas contends the inclusion of these projects in the Mid-Tex rate base is improper. Project No. 010.11352 involved Information Technology for the remodeling of an office in New Orleans. Its allocated cost to Mid-Tex was $20,931.[77] The City of Dallas believes this allocated cost should be removed. Project No. 010.11353 includes leasehold improvements for the New Orleans office. Included in this improvement was the installation of a shower.[78] Its allocated cost to Mid-Tex was $50,362.

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74 Atmos Ex. 15, Petersen Rebuttal at 22-23.
75 Dallas Ex. 4, Pous Direct at p. 30.
76 Atmos Ex. 15, Petersen Rebuttal at 27.
77 Exhibit JSK-3, page 1 of 3 line 35.
78 Volume Three Transcript pages 209-215.

According to Atmos, the relationship between this New Orleans office and Mid-Tex is an employee, Jason White. Jason White, who is responsible for gas supply for Mid-Tex, offices in Dallas. Mr. White's manager has his office in New Orleans.[79] Atmos reasons it is this relationship of Mr. White's manager officing in New Orleans, that provides for the allocation of office remodeling costs to Mid-Tex.

Examiner' Analysis and Recommendation

The Examiners find it reasonable to allocate a portion of the manager's salary expense for supervision of Mr. White. However, allocating the New Orleans Office remodeling expense because the manager has his office at that location was not shown to be reasonable. No evidence was presented that shows the office itself in New Orleans benefits the Mid-Tex customers. The evidence presented shows the manager's supervision of Mr. White may benefit the Mid-Tex customer. The Examiners recommend the remodeling cost of $71,293 allocated to Mid-Tex be removed from rate base. The effect of its removal is an $8,904 reduction to the revenue requirement.

F. Accumulated Deferred Income Taxes ("ADIT")

Dallas proposes that twelve ADIT debits be removed from Atmos' rate base.

Entity	Description of ADIT debit	Amount
Mid-Tex	Insurance accrual	$1,427,110
Mid-Tex	Benefits accrual	$17,483,512
Mid-Tex	Allowance for doubtful accounts	$2,459,265
Mid-Tex	UNICAP Sec. 263(a) costs	$1,472,751
Mid-Tex	Gas storage WACOG to FIFO adjustment	$6,101,477
Mid-Tex	Other	$184,640
Shared Services	Insurance accrual	$55,244*
Shared Services	Benefits accrual	$16,775,525*
Shared Services	Regulatory liability	$72,395*
Shared Services	Financial Accounting Standard (FAS) 115	$2,501,849*
Shared Services	Treasury lock adjustments	$6,323,674*
Shared Services	Other	$1,528,220*

[79] Volume Three Transcript page 214:10-17.

* Reduction to Shared Services portion of rate base, prior to allocation to Mid-Tex

Dallas' witness Hugh Larkin testified that certain ADIT debits have the effect of increasing the rate base. Mr. Larkin testified that, if an ADIT debit is added to rate base, the corresponding liability that gave rise to the ADIT debit must be deducted from rate base, so that the correct amount of cost-free capital (meaning capital derived from rates paid by utility customers upon which the utility pays no borrowing costs) is reflected in the rate base. Dallas recommends certain ADIT debits be removed from rate base primarily because Atmos did not deduct the corresponding liabilities from rate base. Thus, according to Dallas, rate base is overstated by the amount of the ADIT credits.[80]

Dallas' witness provided an illustration of how an ADIT debit arises. In the illustration, a utility creates a reserve fund for injuries and damages.[81] The Internal Revenues Service, however, does not consider a contribution to a reserve fund to be a tax-deductible expense; instead, when an injury occurs and actual damages are paid, the damages payment becomes a tax-deductible expense for the utility. Before an injury occurs and before actual damages are paid, the utility's books temporarily reflect a higher level of income and the utility initially pays a higher level of taxes because the injuries and damages reserve amounts have not been deducted from the utility's taxable income. Once an injury occurs and damages are paid, the utility's income and income taxes are lower than they otherwise would be, due to recognition of the damages expense in a period subsequent to the period in which the reserve fund was created.

UNICAP 263A and WACOG to FIFO. With respect to the Mid-Tex UNICAP 263A cost and the Mid-Tex WACOG to FIFO adjustment, Dallas recommends the related ADIT debits be removed from rate base because both are Atmos' pipeline company costs which should not be recovered through rates levied upon Mid-Tex's local distribution customers. UNICAP 263A costs are related to storage gas inventories and working gas inventories which were moved by the Commission to Atmos' pipeline company's cost of service in Docket No. 9400. Atmos' WACOG to FIFO adjustment relates to the company's conversion from a WACOG inventory method to a FIFO inventory method for gas storage balances which were moved by the Commission to the pipeline company's cost of service in Docket No. 9400.[82]

FAS 115. With respect to the Shared Services Financial Accounting Standard (FAS) 115 ADIT debit, Dallas explains that FAS 115 establishes how an entity should value debt or equity held for investment. Dallas asserts that Atmos did not show that holding debt or securities for investment is related to the provision of gas service by Mid-Tex; thus, Dallas recommends the FAS 115 ADIT debit be removed from rate base.[83]

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[80] Dallas Ex. 2, Larkin Direct, p. 6-7 and 8/20/09 Tr. at 110-112

[81] 8/20/09 Tr. at 110-111

[82] Dallas Ex. 2, Larkin Direct, p. 10-12

[83] Dallas Ex. 2, Larkin Direct, p. 14

Treasury lock adjustments. With respect to the Shared Services treasury lock adjustment, Dallas noted that Atmos incurred a loss of $43.8 million due to cash flow hedging. For tax purposes, a deferred tax asset was recorded to recognize the unrealized loss. Dallas recommends removal of the treasury lock adjustment because Atmos did not explain how the ADIT debit, which is an increase to rate base, resulted from a hedging loss; moreover, Atmos did not reveal where the related credit balance was reflected as an offset to the rate base.[84]

Period of calculation of ADIT balances. Dallas' calculation of the removal of Atmos' ADIT debits was based upon 12/31/08 adjusted per book amounts found on workpaper WP_B-3 in Atmos' 4/23/09 Statement of Intent.[85] According to Dallas, however, Atmos' calculation of ADIT balances through 12/31/08 is inconsistent with Atmos' adjustments to gross plant and depreciation reserves through 3/31/09.[86] Dallas recommends the Commission allow known and measurable post test year adjustments only through 12/31/08, six months beyond the end of the test year, so that gross plant, depreciation reserves, and ADIT balances are aligned on a single, matching date, 12/31/08.[87]

Atmos' witness Petersen testified that the company's method of recording ADIT balances in Docket No. 9869 is the same as the method used in Docket Nos. 9762 and 9670. That is - the company began with a presumption that all per book ADIT balances related to the company's jurisdictional business should be included in rate base and that exclusions should be limited to those items excluded by the Commission in prior cases. Because the same method was used by Atmos in prior cases, Atmos urges the Commission to include the challenged ADIT debits in rate base in Docket No. 9869.[88] Atmos' counsel claims that Atmos uses the normalization approach described in the Commission's Rate Review Handbook.[89]

A second Atmos witness McDonald explained that ADITs arise because of differences between the Internal Revenue Code and U.S. Generally Accepted Accounting Procedures (GAAP). Because of these differences, Atmos defers recognition of certain tax liabilities and benefits to a future period.[90] The witness noted throughout his testimony that, when Atmos temporarily incurs a higher level of taxes, the company recoups those higher cash taxes in a future period.

Atmos' witness responded to Dallas' assertion that each rate-base-increasing ADIT debit must be counter-balanced with a recognition of the corresponding rate-base-reducing liability by describing a pension scenario where a utility could have an ADIT balance for an item that has a zero balance in the corresponding balance sheet account.[91]

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84 Dallas Ex. 2, Larkin Direct, p. 16
85 Dallas Ex. 2, Larkin direct, p. 7
86 Dallas Ex. 4, Pous direct, p. 9
87 Dallas Ex. 4, Pous direct, p. 13
88 Atmos Ex. 15, Petersen rebuttal, p. 28
89 Atmos Brief, p. 12
90 Atmos Ex. 19, McDonald rebuttal, p. 9
91 Atmos Ex. 19, McDonald rebuttal, p. 10

Atmos described the difference in accounting for deferred taxes under GAAP and under the Internal Revenue Code. Atmos' witness explained that many of the differences are temporary, meaning that the total amount of income or expense recognized for an item may be the same under GAAP and the Code; but the time period over which those items are recognized is different. A $100 item purchased by Atmos may be capitalized and depreciated over 30 years under GAAP, while the Code may allow a depreciation period of 15 years for the same item.[92]

FAS 115. In response to Dallas' concern that the Shared Services FAS 115 ADIT debit is not related to the provision of utility services, Atmos' witness testified that the debt or securities underlying the FAS 115 deferred tax asset are held to fund certain employee benefit programs and, therefore, are related to the provision of utility services.[93] Thus, according to Atmos, the FAS 115 ADIT debit should be included in rate base.

Treasury lock adjustments. In response to Dallas' assertions, Atmos' witness testified that the treasury lock ADIT debit was recorded in "Accumulated Deferred Income Taxes" and the corresponding credit, or loss, was recorded in "Accumulated Other Comprehensive Income." Atmos' witness testified that, according to the Internal Revenue Service, the hedging loss is deductible over the life of the financing which the instruments were meant to hedge. Thus, according to Atmos, it is appropriate that the ADIT debit be recorded on the company's books to reflect the future benefit the company will receive when the loss is deducted on future tax returns. Until the losses are recognized, the company pays additional taxes. Taxable income and taxes will be reduced in future periods, when the losses are recognized.[94]

Insurance accruals. In response to Dallas' assertion that Atmos did not record a reduction to rate base related to its ADIT debits for insurance accruals, Atmos' witness pointed out that the company's calculation of rate base includes a $2,591,982 reduction to the injuries and damages reserve.[95] The reduction includes $2,461,352 for Mid-Tex $340,183 for Shared Services before allocation of a portion to Mid-Tex.[96]

Atmos submitted several contingency recommendations should the Commission adopt Dallas' proposals on ADIT:

- If the Commission adopts Dallas' proposal on insurance accruals, Atmos' witness recommends the before-tax ADIT debits for insurance accruals be adjusted through 12/31/08 to $935,314 for Mid-Tex and $129,269 for Shared Services.[97]
- ADIT credits. If the Commission adopts Dallas' proposal on ADIT debits, Atmos recommends ADIT credits be treated in the same way. Thus, a $524,148 ADIT credit for

92 Atmos Ex. 19, McDonald rebuttal, p. 9
93 Atmos Ex. 19, McDonald rebuttal, p. 5, 16
94 Atmos Ex. 19, McDonald rebuttal, p. 17-18
95 Atmos Ex. 19, McDonald rebuttal, p. 11, 14
96 The allocated portion to Mid-Tex is $130,630.
97 Atmos Ex. 19, McDonald rebuttal, p. 20 and Exhibit PM-R-1

Deferred Expense Projects and a $281,731 ADIT credit for Regulatory Assets through 12/31/08 should be removed from ADIT balances.[98]

- Tax rate adjustment. If the Commission adopts Dallas' proposal to remove certain ADIT debits, Atmos recommends modifying the 38% composite income tax rate it used to a 35% federal income tax rate, as calculated by Atmos' witness, through 12/31/08.[99]
- Period of adjustment. If the Commission adopts Dallas' proposal, Atmos witness McDonald's adjustments to ADIT through 12/31/08 must be reconciled with Atmos witness Petersen's adjustments to ADIT through 3/31/09.[100]

Examiners Analysis and Recommendation

The Examiners are unaware of the Commission litigating the ADIT debit issues presented by Dallas in this docket prior to this docket. Neither Staff nor the State presented evidence on ADIT debits. Nevertheless, State argues that the Commission should remove from rate base Atmos' ADIT debits for employee benefit accruals (pensions), insurance accruals, allowance for doubtful accounts, UNICAP 263(a) and the WACOG to FIFO adjustment - because the State believes Atmos did not meet its burden of proof.[101] Atmos argues in its closing brief that Mr. Larkin inappropriately proposes excluding certain ADIT debits from rate base which in effect prevents the utility from recovering a return on money paid to the U.S. Treasury before those amounts are recognized on the utility's books.[102] Atmos also states that on a net basis the recognitions of all ADIT accounts has significantly reduced the requested rate base.[103] Mr. McDonald testified that a problem with Mr. Larkin's proposal is that it "gives no consideration as to whether the activity which gave rise to the ADIT debit is included in cost of service."[104] The Examiners are unable to find that Dallas' proposal should be adopted. The Examiners are not able to determine from the testimony and evidence presented by Dallas on this issue that Atmos' treatment of ADIT is inappropriate and therefore unreasonable. This issue is complex and involves a determination of the financial benefits under rate-making principles that arise from the timing differences from Revenue Code and the utility's books. We do not find Dallas' testimony and evidence sufficient to allow us to recommend the Commission's adoption of these proposed changes, other than the transfer of UNICAP 263A costs and WACOG to FIFO costs from Mid-Tex to Atmos-Pipeline.

<u>G. Storage Gas</u>

Atmos has included in this filing in both rate base and its cost of service expenses related to storage gas. Included in this issue is the change in accounting of storage gas from weighted average cost of gas (WACOG) to first-in, first-out (FIFO). This change has created an Accumulated

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98 Atmos Ex. 19, McDonald rebuttal, p. 21, and Exhibit PM-R-1
99 Atmos Ex. 19, McDonald rebuttal, Exhibit PM-R-1
100 Atmos Ex. 19, McDonald rebuttal, p. 23
101 State's Initial Brief, pp. 1 and 13-15
102 *Initial Brief of Atmos Energy Corp., Mid-Tex Div.* at 13.
103 *Initial Brief of Atmos Energy Corp., Mid-Tex Div.* at 13.
104 Atmos Ex. 19, McDonald Rebuttal, p. 7.

Deferred Income Tax (ADIT) debit in the amount of $4,266,536[105] (at March 31, 2009) or $6,101,477[106] (at December 31, 2008). ADIT has a direct effect on the rate base. Atmos has, in the cost of service, also claimed $3,300,958 in property taxes in 2008[107]. City of Dallas witness Jacob Pous states expenses associated with storage gas is a Atmos Pipeline-Texas (Pipeline) asset and should not be included in Mid-Tex costs.[108] Hugh Larking, Jr., witness for the City of Dallas, has identified the deferred income tax debit of $6,101,477 as the income tax effect in changing from WACOG to a FIFO accounting method for the inventory of storage gas.[109] Dallas has also identified $1,472,751 as an ADIT Debit as UNICAP Section 263A costs associated with storage gas inventory and working gas inventory[110].

Atmos has stated that working gas in storage was removed from distribution to Pipeline in GUD No. 9400. Atmos contends the Commission further determined that all other items related to working gas in storage, including property taxes and ADIT related to UNICAP Section 263A, should remain in distribution's revenue requirement.[111] Atmos witness Thomas Peterson also states the Commission has repeatedly reached this conclusion by approving the revenue requirement in GUD Nos. 9670 and 9762. And, that Atmos is following this precedent in preparing the distribution system revenue requirement in this case.[112] Atmos claims that denying Mid-Tex its claimed expenses associated with ADIT and property taxes, the company will be denied proper recovery.

The City of Dallas challenges Atmos' contention that the Commission has made specific determinations that these expenses stay in distribution. The City of Dallas states, "There is, in fact, no such finding in GUD 9400, GUD 9670, or GUD 9762. There is no mention in the Proposals for Decision, the Final Orders or the Final Order Schedules of any inclusion or non inclusion of property taxes related to working gas in storage."[113] Dallas also contends the ADIT effect has not occurred in the previous distribution cases until this case.[114]

State of Texas confirms neither the WACOG to FIFO or the UNICAP Section 263A issues of ADIT were litigated in previous Mid-Tex rate cases. State of Texas believes these are Pipeline costs and recommends removal of these debits from rate base.[115]

Examiners' Recommendation

A review of the PFD's was made of GUD Nos. 9400, 9670 and 9762 for any discussion or

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[105] Errata Work paper B-3 at line 16.
[106] Revised Work paper B-3 at line 16.
[107] Dallas witness Jacob Pous Direct Testimony page 69 line 7.
[108] Dallas witness Jacob Pous Direct Testimony page 68 lines 19-20.
[109] Dallas witness Hugh Larkin, Jr. Direct Testimony page 11 lines 7-20.
[110] Dallas witness Hugh Larkin, Jr. Direct Testimony page 10 lines 1-11.
[111] Atmos witness Thomas Peterson Rebuttal, page 30 lines 12-16.
[112] Atmos witness Thomas Peterson Rebuttal, page 30 lines 118-20.
[113] City of Dallas Initial Reply page 36.
[114] City of Dallas Reply Brief page 9.
[115] State of Texas Initial and Reply Briefs, pages 15 and 19, respectively.

comments regarding property taxes on storage gas or ADIT debits or credits. A reference or discussion could not be found that was specific to property taxes on storage gas or ADIT. As a result, the Examiners conclude the issue of property taxes on storage gas or ADIT effects from storage gas valuations included in the cost of service in Mid-Tex or Pipeline has not been litigated prior to this case. There was no discussion in GUD No. 9400 that discussed a splitting of expenses or costs between the two entities, Atmos Mid-Tex or Atmos Pipeline-Texas. The Examiners find it reasonable to view the expenses associated with storage gas as a pipeline expense. Supporting evidence of this conclusion is Findings of Fact (FOF) 36, 37 and 38 in the Final Order of GUD No. 9400. FOF 36 found Line Pack Gas was used and useful and included in invested capital for pipeline. FOF 37 found Cushion Gas was used and useful and included in invested capital for Pipeline. FOF 38 found it reasonable to remove $98,182,654 from Distribution's invested capital for Working Gas in Storage and include it in Pipeline's invested capital.[116] The evidence presented in this docket supports the concept that expenses related to storage gas is more appropriately a Pipeline expense than a distribution expense. As these two entities are Atmos companies and by the fact that Atmos Pipeline-Texas will be filing a Statement of Intent in February 2010[117], there should be no loss of expenses to Atmos by Pipeline claiming these expenses. The Examiners recommend $3,300,9858 in property taxes be removed from the cost of Service. The Examiners further recommend both ADIT Debits for UNICAP Section 263A, $1,472,751, and the WACOG to FIFO, $6,101,477, be removed from rate base.

VI. MID-TEX EXPENSES

A. Incentive Compensation

In this case, Atmos requests approval of incentive compensation for employees. David C. Park, Vice President of Rates and Regulatory for Atmos, testified in support of Atmos' employee compensation proposals.[118] Mr. Park testified that Atmos is requesting recovery of all types of compensation approved by the Commission in GUD No. 9762. He testified that the Management Committee incentive compensation costs that were excluded in GUD No 9762 have been excluded.[119] He testified that Atmos' total compensation packages are within the middle of the market for employees.

Dallas opposes Atmos' proposed incentive compensation expense. Mr. Pous testified that Atmos has included $5,744,689 in incentive compensation in this request, consisting of $3,544,716 in SSU expenses and $2,229,973 of direct incentive expenses.[120] Ms. Myers changed this amount

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[116] GUD No. 9400 FOF 36, 37, 38, Schedule H(P) – invested Capital page 4 of 4 lines 11, 12, 13.
[117] Tex. Util. Code § 104.301(h) requires a utility to file a rate case before the fifth anniversary of its first implementation of a tariff or rate schedule under this section. Atmos Pipeline-Texas implemented its first Interim Rate Adjustment on March 25, 2005.
[118] Atmos Ex.5, Park Direct. Atmos Ex. 12, Park Rebuttal.
[119] Atmos Ex. 5, Park Direct, p. 13.
[120] Dallas Ex. 4, Pous Direct, p. 32.

in rebuttal to $5,163,684.[121] Mr. Pous testified that the Commission should not approve incentive compensation because Atmos does not have to pay it and that shareholders are the direct beneficiaries as incentive compensation is based on financial performance.[122] Mr. Pous also testified that an additional $1,989,982 needs to be removed from rate base to account for the capitalized portion of SSU incentive compensation.[123] Mr. Pous testified that the criteria used to set incentive compensation are primarily the financial performance of the utility.[124] Dallas argues that it is primarily shareholders that benefit and that shareholders and not rate-payers should bear the costs associated with incentive compensation. Mr. Park testifies in his rebuttal of Mr. Pous that the Commission has previously recognized incentive pay as a reasonable, known and measurable expense and that Atmos' requested level is based on actual test year data.[125] He also testifies that safety criteria also impact the level of incentive compensation and that it does directly benefit ratepayers.

Examiners' Analysis and Recommendation

The arguments for and against incentive pay are primarily policy arguments. There is no evidence that the ultimate level of employee compensation paid by Atmos during the test year is unreasonably higher than the market price for such labor. The testimony in the record indicates that Atmos pays its employees at the mid-point of the market. The Commission recently approved the recovery of incentive compensation for direct employees of CenterPoint Energy Entex in GUD No. 9791. There is no evidence that Atmos is spending an unreasonable level on the aggregate compensation of its employees. There is no evidence in the record that establishes that the method of compensation (incentive) is likely to cause performance or public safety problems in Atmos' provision of gas service to the public. The Examiners therefore recommend that the Commission approve Atmos' requested level of payroll expense which includes an amount for incentive compensation.

B. Merit Increases

Ms. Myers testified that an adjustment was made to annualize employee base salaries and to include a 3.5 percent annual merit increase which occurred and was effective October 1, 2008.[126] She testified that this is the same calculation method that was approved in GUD No. 9762.

Dallas challenges Atmos' proposed 3.5 percent post test-year salary increase. Mr. Pous testified that Atmos' request is an unreasonable post test-year adjustment. He testified that it "is neither reasonable nor necessary to implement a post test year salary increase, which is passed onto

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121 Atmos Ex. 14, Myers Rebuttal, p. 30.
122 Dallas Ex. 4, Pous Direct, p. 34-36.
123 Dallas Ex. 4, Pous Direct, p. 36.
124 Dallas Ex. 4, Pous Direct, p. 34,
125 Atmos Ex. 12, Park Rebuttal, p. 16-17.
126 Atmos Ex. 7, Myers Direct, p. 24.

customers, when the economy dictates that salary increases are not warranted."[127] He testified that Atmos has not demonstrated in the current economic condition a need for increases in salaries from test year salary levels. Mr. Pous recommends the Commission disallow the post test-year salary adjustment and reduce salary expense $1,718,666 and reduce an additional $1,578,538 from capitalized salary.[128]

Mr. Park testified that the merit increase was implemented and was therefore known and measurable. He testifies that the merit increase is reflective of the job markets in which Atmos competes and that the company cannot hire people if they are not fairly compensated.[129] He testified that the merit increases are one part of the total compensation and that this compensation falls within the middle of the competitive job market range.

Examiners' Analysis and Recommendation

Mr. Pous' testimony is essentially that under current economic conditions, Atmos can not justify increasing the wages and salaries of its employees by the merit increase. Atmos introduced testimony that its compensation package is in the middle of the range for such compensation. Dallas has not submitted sufficient evidence that leads the Examiners to reasonably conclude that the total compensation paid by Atmos is unreasonable or too high. The fact that the current economy is bad is not evidence that Atmos' proposed expense is somehow unreasonable or improper. Absent evidence that Atmos is incurring unreasonably high payroll expense, the Examiners find no basis to recommend a disallowance of this particular adjustment. The Examiners therefore recommend that the Commission approve Atmos' requested level of payroll expense which includes an adjustment for merit increases.

C. Overtime Expense

Dallas proposes a three year averaging adjustment to Atmos' overtime expense. Mr. Pous testified that overtime expenses vary from year to year and is dependant on the activities, projects, weather conditions and other activities. As a result of such variance, Mr. Pous proposes that a three year average of this expense be used in lieu of the test year amount proposed by Atmos. He recommends that the Commission approve the three year average overtime expense of $5,560,898, which results in a $447,734 reduction to Atmos' revenue request.[130]

Mr. Knights testified that Mr. Pous did not offer evidence that the test year costs are not representative of the expected level of future costs and absent such evidence, there is no rational basis to use non-test year data. He also testifies that no evidence has been submitted to support the conclusion that future costs will be the average of past years costs.[131] He testified that in GUD Nos.

[127] Dallas Ex. 4, Pous Direct, p. 36.
[128] Dallas Ex. 4, Pous Direct, p. 36-37.
[129] Atmos Ex. 12, Park Rebuttal, p. 12.
[130] Dallas Ex. 4, Pous Direct, p. 37-38.
[131] Atmos Ex. 18, Knights Rebuttal, p. 8.

9670 and 9762 the Commission approved Atmos' proposed overtime expense which was based on test year levels of expense.[132] Mr. Knights testified that the overtime expenses requested are actual costs incurred during the test year. He testified that the company's increased overtime expense level reflects Atmos using existing employees instead of hiring more outside contractors.[133] He testified that Atmos continuously tries to "right size" and has determined it to be a better practice to use company personnel to perform certain functions. As a result he expects Atmos to continue to incur overtime expenses at least equivalent to the test year level requested in this docket.[134]

Examiners' Analysis and Recommendation

The Examiners find that there is not sufficient evidence to overturn the presumption that Atmos' proposed overtime expense level is reasonable. There is no evidence in the record that establishes Atmos incurred unnecessary overtime expenses or mismanaged its employees so that excessive overtime was taken during the test year. The evidence in the record demonstrates that the actual test year overtime expense level is representative of expected future overtime expenses. Additionally, the evidence suggests that Atmos reasonably incurred overtime expenses. Mr. Knights testified that due to Atmos' increasing emphasis on utilizing internal resources as opposed to outside contractors, it is likely that the test year overtime expense level will be incurred going forward. Mr. Knights testified that the utility determined it to be more cost efficient to use internal resources than outside contractors. Therefore, the Examiners recommend that the Commission approve Atmos' requested test year level of overtime expense.

D. Employee Benefits Expense

Dallas challenges the utility's medical and dental benefits expense level. Mr. Pous testified that Atmos initially proposed a $1,148,279 increase in this expense level but that Ms. Myers stated that the level was incorrect and overstated by $2,336,742.[135] Mr. Pous testified that Atmos' projection for future medical and dental expense is not known and measurable with reasonable accuracy in violation of §103.055(a). He testified that Atmos relied incorrectly on a projected $8,281 per employee medical and dental cost. Mr. Pous testified that the actual cost is $5,295 per employee.[136] "Further, while the Company claims an increase in medical costs per employee and an increase in the number of employees it also reports a year to year decline of $693,917 of actual test year costs for medical and dental expense associated with its Mid Tex direct component."[137] He testified that the only information known with reasonable accuracy applicable to Atmos' medical and dental costs are the actual test year amounts and the corresponding number of employees reported. He proposes that the actual test year amount divided by the test year number of employees should

[132] Atmos Ex. 18, Knights Rebuttal, p. 12.
[133] Atmos Ex. 18, Knights Rebuttal, p. 13.
[134] Atmos Ex. 18, Knights Rebuttal, p. 14.
[135] Dallas Ex. 4, Pous Direct, p. 39.
[136] Dallas Ex. 4, Pous Direct, p. 39-40.
[137] Dallas Ex. 4, Pous Direct, p. 40.

be used, yielding a $5,295 per employee medical and dental benefits expense.[138] This results in a total revenue adjustment of $2,458,940.

Ms. Myers testified in response to Mr. Pous' proposal regarding the medical and dental benefits expense.[139] Ms. Myers testified that the proposed adjustment to medical and dental benefits was made "to calculate benefit expense at the most current benefit rate available in light of the increasing cost of benefits" and was "based on the actual number of employees for both Mid-Tex and SSU."[140] She testified that Mr. Pous analysis focuses "only on the total actual test year costs for Mid-Tex and not on the cost of the benefits themselves as provided by Towers Perrin for both Mid-Tex and SSU."[141] She testified that Atmos has experienced an increase in the number of employees. Atmos calculated a projected benefit of $8,316 per employee based on information from Towers Perrin and that this represents a $35 per employee increase from the amount approved in GUD No. 9762.[142] Ms. Myers testified that the actual cost per SSU employee was $7,562, unlike the actual cost per Mid-Tex employee of $5,295.

Examiners' Analysis and Recommendation

The evidence in the record shows that the employee benefits expense is based on the projected per employee cost. The adjustment was based on a comprehensive study performed by Towers Perrin taking into account multiple factors that influence these costs. There is not sufficient evidence in the record to establish that this study or the projected benefits expense are flawed, unreliable, unreasonable or represent a level of benefits that are not likely to occur. The increase per employee is $35 from the last rate case. The evidence weighs in favor of using the adjusted expense amount for this account as the testimony and study show that based on the actuarial factors of Atmos' workforce the utility is likely to incur that level of medical and dental expense going forward. Therefore the Examiners recommend that the Commission approve Atmos' requested test year level of employee benefits expense.

E. Uncollectible Expense

On July 21, 2009, the Commission approved an interim order in this docket finding that the use of a three year average for uncollectible expense, as approved in GUD No. 9762, is reasonable. Dallas, subsequently filed supplemental witness testimony of Mr. Pous which concerns the three year average of uncollectible expense.[143] Mr. Pous testified that it is necessary to normalize the three year average due to abnormally high uncollectible expenses during the last 7 months of calendar year 2006.[144] He testified that the last seven months of 2006 is 2.4 times the 2005 level and 1.6 times the

138 Dallas Ex. 4, Pous Direct, p. 40.
139 Atmos Ex. 14, Myers Rebuttal, p. 6-11.
140 Atmos Ex. 14, Myers Rebuttal, p. 6-7.
141 Atmos Ex. 14, Myers Rebuttal, p. 7.
142 Atmos Ex. 14, Myers Rebuttal, p. 7.
143 Dallas Ex. 4b, Pous Supplemental Direct.
144 Dallas Ex. 4b, Pous Supplemental Direct, p.2.

2007 level of uncollectible expense. He therefore proposes removing calendar year 2006 from the average and using calendar year 2005 in the three year average approved by the Commission. The result is a reduction of $834,051 from the revenue requirement of Atmos.[145]

Ms. Myers rebutted the supplemental testimony of Mr. Pous.[146] Ms. Myers testified that "Mr. Pous did not calculate an average of 3 years, as he states but rather calculates averages of averages" and that "it appears that he has calculated multiple averages (one average using the 7 month periods from 2005, 2007 and 2008 and another using the periods 2005, 2006 'as adjusted for his calculated average' and 2007) to arrive at his '3-Year Normalized Average.'"[147] Ms. Myers testified that Atmos has relied on a mathematical average of the three consecutive years (2005, 2006, and 2007) and that this is consistent with the method approved by the Commission in GUD No. 9762. Ms. Myers also testified that 2006 was not an outlier year and that the level of expense in both 2005 and 2006 is within the normal range.

Examiners' Analysis and Recommendation

The Commission approved a three year average in GUD No. 9762 and has also determined that a three year average for uncollectible expense in this docket is reasonable. The Examiners find that Mr. Pous' normalization calculation methodology is not consistent with the interim ruling of the Commission in this docket, as he does not appear to have proposed a simple average of three years worth of data. Further, the evidence and testimony introduced by Ms. Myers establishes that the levels of uncollectible expense in 2005 and 2006 are within the normal range. Thus there is no established need to normalize or remove outlier data that would have the effect of skewing the average of uncollectible expense. Although the 2006 data set is higher than the 2005, 2007 and 2008 data sets, there is not sufficient evidence to remove the 2006 data set as atypical and not likely to occur in the future, therefore it is reasonable to include that data set in the three year average for uncollectible expense. The Examiners therefore recommend that the Commission approve Atmos' level of uncollectible expense.

F. Outside Services Expense

Dallas challenged the level of outside services expense requested by Atmos. Mr. Pous testified that Atmos' historical level of outside services expense has varied significantly and therefore this expense should be normalized.[148] Mr. Pous testified that the level of contract legal expenses had increased 141% but that Atmos failed to justify the test year level of this expense as a reasonable ongoing level and therefore normalization is required.[149] Mr. Pous proposes using a three year average of the expense level approved in GUD Nos. 9670, 9762 and Atmos' request in

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[145] Dallas Ex. 4b, Pous Supplemental Direct, p.3.
[146] Atmos Ex. 14A, Myers Supplemental Rebuttal
[147] Atmos Ex. 14A, Myers Supplemental Rebuttal, p.3.
[148] Dallas Ex. 4, Pous Direct, p. 57.
[149] Dallas Ex. 4, Pous Direct, p. 58.

this proceeding.[150]

Mr. Knights testified that in GUD Nos. 9670 and 9762 the actual test year levels of these expenses were approved.[151] He testified that Dallas' witness has proposed using an averaging approach without showing that the actual costs incurred are unreasonable.[152] He testified that Atmos is expecting this level of expense to occur going forward due to an increasing focus on encroachments of rights-of-way and other legal issues.[153] He testified that Dallas has not identified a single activity or cost that was not reasonable and necessary to the operation of the gas system during the test year.[154]

Examiners' Analysis and Recommendation

The evidence in the record indicates the expense incurred during the test year in this account was reasonable. Dallas' proposal to use an average is in effect a method to lower the expense. However, there is insufficient evidence in the record to justify lowering this expense as an unreasonable amount that is not likely to occur in the future, or that the expense level is due to unreasonable or unnecessary costs incurred during the test year. The Examiners therefore recommend that the Commission approve Atmos' level of outside services expense.

G. Distribution Load Dispatching Expense

Dallas opposes Atmos' requested level of Distribution Load Dispatching Expense – Account 871. Mr. Pous testified that this expense has increased significantly since the last rate case. He testified that the expense level for this account was $458,390 in GUD No. 9670, $976,983 in GUD No. 9762, $1,789,871 in the present docket and that Atmos is unable to explain the increase in this account.[155] He reviewed monthly totals for this account and testified that odorization expenses fluctuate greatly, do not follow a constant or predictable pattern, and therefore some form of normalization is necessary.[156] He recommends averaging this account by using a three year average of the requested amount and the amounts approved in GUD Nos. 9670 and 9762 which results in a $714,790 decrease in the account.[157]

Mr. Knights testified in rebuttal to Mr. Pous' recommended normalization of this expense. He testified that Mr. Pous' basis for the disallowance is that costs increased and that Mr. Pous' recommendation ignores the actual necessity and reasonableness of the costs.[158] He testified that in

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150 Dallas Ex. 4, Pous Direct, p. 58.
151 Atmos Ex. 18, Knights Rebuttal, p. 15.
152 Atmos Ex. 18, Knights Rebuttal, p. 16.
153 Atmos Ex. 18, Knights Rebuttal, p. 16.
154 Atmos Ex. 18, Knights Rebuttal, p. 17.
155 Dallas Ex. 4, Pous Direct, p. 58.
156 Dallas Ex. 4, Pous Direct, p. 59.
157 Dallas Ex. 4, Pous Direct, p. 59.
158 Atmos Ex. 18, Knights Rebuttal, p. 18.

GUD No. 9762 the Commission approved the test year level of this expense. He testified that the primary cost driver is the purchase of odorant, that there was a 45% average unit price increase for odorant between the current test year and the GUD No. 9762 test year, and that volumes increased by 27 percent.[159] He testified that Atmos' requested expense is the actual test year amount and that for calendar year 2009 the odorant costs remain in the same range as in 2008.[160]

Examiners' Analysis and Recommendation

The evidence in the record indicates that the distribution load dispatching expense during the test year was reasonable. The evidence shows that the primary cost driver, the cost of odorant, increased along with the volumes of gas treated. There is no evidence in the record to indicate that this expense level was an anomaly and that the costs and volumes treated are not likely to occur in the future. The Examiners therefore recommend that the Commission approve Atmos' level of distribution load dispatching expense.

H. Gasoline Expense

Dallas opposes Atmos' recovery of the test year amount for gasoline expense. Mr. Pous testified that Atmos paid an average of $4.61 per gallon for diesel fuel and $3.86 per gallon for regular unleaded gasoline during the test year. He testified that the average gasoline price during the test year was $3.07, and that it was $2.00 for the first half of calendar year 2009 as reported by the Energy Information Administration. He testified that the test year price of gasoline was on average 53% higher than the first half of 2009.[161] Mr. Pous recommends that Atmos' gasoline expense be normalized to reflect the average price during the calendar year 2009 compared to the identifiable gasoline and diesel purchases during the test year. The impact of this recommendation is a $464,037 reduction in expenses and $609,874 reduction to capitalized costs.[162]

Mr. Knights testified that there is no reason to expect that the gasoline cost experienced in 2008 is not a reasonable reflection of the costs that will be incurred in the future.[163] He testified that the prices of fuel used by Mr. Pous are unrealistic and that he provided no evidence that Atmos can purchase gas at those amounts. He testified that Atmos based the requested expense on the actual level of costs incurred during the test year, the activities associated with the expense are recurring, and the level of test year costs are the most accurate reflection of costs Atmos expects to incur during the period of time new rates will be in effect.[164]

[159] Atmos Ex. 18, Knights Rebuttal, p. 18-19.
[160] Atmos Ex. 18, Knights Rebuttal, p. 20.
[161] Dallas Ex. 4, Pous Direct, p. 60.
[162] Dallas Ex. 4, Pous Direct, p. 61.
[163] Atmos Ex. 18, Knights Rebuttal, p. 28.
[164] Atmos Ex. 18, Knights Rebuttal, p. 29.

Examiners' Analysis and Recommendation

The evidence in the record indicates that the price per gallon of gasoline and diesel during the test year was higher than current market prices for fuel. There is no evidence that fuel expenses are likely to remain below the test year amount and that therefore the test year level of costs are likely to exceed what the utility is likely to incur going forward. Gasoline and diesel fuel is a commodity with sometimes volatile prices. Evidence in this docket leads the Examiners to conclude that the test year amount of this expense will allow the utility to recover a reasonable level of revenue from rate payers in the ultimate rates approved by the Commission. Given the evidence introduced in this docket, there is no basis to conclude that fuel costs are more likely to remain below the test year amount or that fuel prices are likely to exceed the test year amount. The Examiners therefore recommend that the Commission approve Atmos' test year level of gasoline expense for use in setting rates in this proceeding.

I. Pipeline Integrity Charges

Dallas opposes Atmos' recovery of the test year amount for pipeline integrity testing expense. Mr. Pous testified Atmos' pipeline integrity expenses varied over the previous three years from a low of $777,411 to a high of $2,152,759.[165] He testified that Atmos has a seven to twenty year "cycle period" for these expenses, and that as a result the level of expense varies from year to year.[166] He testified that Atmos has requested an artificially excessive level of pipeline integrity expense and that this expense should be normalized because Atmos was in a catch-up mode during the test year due to deferrals of projects from prior years.[167] Mr. Pous recommends the average of the last three years of O&M expense for pipeline integrity charges. His proposal will reduce O&M expense by $393,821.

Mr. Knights testified that the Commission requires integrity tests be conducted pursuant to an integrity management plan. He testified that test year pipeline integrity costs are an accurate reflection of the costs which can be expected in the future because these activities have to be conducted on an ongoing basis. He testified that projects are done each year and actual test year data reflects the current costs and what is expected in the future.[168] Mr. Knights testified that the state and federal regulations pertaining to integrity testing provide for initial and on-going integrity testing which will continue the upward pressure on this expense.[169]

Examiners' Analysis and Recommendation

The evidence in the record indicates the expenses associated with pipeline integrity testing during the test year are reasonable. There is no evidence which identifies any particular charge as

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[165] Dallas Ex. 4, Pous Direct, p. 62.
[166] Dallas Ex. 4, Pous Direct, p. 61-62.
[167] Dallas Ex. 4, Pous Direct, p. 62.
[168] Atmos Ex. 18, Knights Rebuttal, p. 22.
[169] Atmos Ex. 18, Knights Rebuttal, p. 23.

unreasonable and or unnecessary. There is evidence that expenses for pipeline integrity testing may vary from year to year and that the test year amount is likely to occur going forward. The Examiners therefore recommend that the Commission approve Atmos' level of pipeline integrity testing expense.

J. Pipeline Employee Expense

Dallas opposes Atmos' recovery of the test year amount for pipeline employee expense. Mr. Pous testified that Atmos is attempting to double recover expenses on behalf of Atmos associated with employees transferred from Atmos Pipeline to Shared Services Unit ("SSU").[170] Mr. Pous testified that "as Atmos Pipeline has transferred employees to Mid-Tex or SSU cost centers that are then allocated to Mid-Tex subsequent to GUD No. 9400, Mid-Tex customers are forced to pay twice for the same employee."[171] He testified that Atmos transferred 14 employees to SSU during the test year and that eight (8) were accounted for in cost centers allocating costs to Mid-Tex. He recommends a dollar for dollar expense credit. He recommends that Atmos identify all labor related transfers from Atmos Pipeline to SSU cost centers that are allocated to Mid-Tex and any employees that may have been directly transferred to Mid-Tex, and those amount be further reduced from the Atmos' revenue requirements.[172] The impact of his recommendation is to reduce expenses $326,055.[173]

Mr. Knights testified in response to Dallas' proposal on pipeline employee expense. He testified that Mr. Pous' recommendation amounts to an unquantified look-back adjustment related to employee transfers since Atmos Pipeline's last rate case.[174] He testified that two of the eight employees were promoted into new positions in Shared Services and the former positions were filled.[175] He testified that the remaining six employees and the job positions were transferred to Shared Services.[176] He proposes that the Commission set rates based on the test year data.

Examiners' Analysis and Recommendation

Dallas alleges that the utility is going to double recover expenses related to eight employees as a result of transfers from Atmos Pipeline to Mid Tex or SSU. There is no compelling evidence in the record that leads the Examiners to conclude that Atmos is engaging in some form of double recovery. The evidence submitted by Dallas does not establish that the expenses associated with the six transferred positions are entered in the utility's books twice and therefore a double recovery is going to occur. The Examiners therefore recommend that the Commission approve Atmos' level

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170 Dallas Ex. 4, Pous Direct, p. 63.
171 Dallas Ex. 4, Pous Direct, p. 63.
172 Dallas Ex. 4, Pous Direct, p. 64.
173 Dallas Ex. 4, Pous Direct, p. 64.
174 Atmos Ex. 18, Knights Rebuttal, p. 30.
175 Atmos Ex. 18, Knights Rebuttal, p. 30-31.
176 Atmos Ex. 18, Knights Rebuttal, p. 31.

of pipeline employee expense.

K. Relocation Expense

Dallas opposes Atmos' recovery of the test year amount for relocation expense. Mr. Pous testified that both the expense and number of employees relocated varies from year to year.[177] Mr. Pous testified that because Atmos' request to recover $630,864 in direct relocation expense is higher than any of the three most recent calendar years, and the cost and number of employees relocated varies yearly, it is necessary to normalize this expense as with uncollectible expense.[178] He recommends that a three year average be used in order to allow Atmos to recover a reasonable and necessary amount and not over-recover costs.[179] Mr. Pous proposes an average of calendar years 2006, 2007, and 2008. The result is a $129,628 reduction in recoverable expenses.

Mr. Knights testified that in both GUD Nos. 9670 and 9762 the Commission approved the test year amount for relocation expense.[180] He testified that it is critical from an operations perspective that the appropriate individuals be in the appropriate job position and located in the appropriate geographic area in order to provide safe and reliable gas service.[181] He testified that there is no basis for concluding that future relocation costs will be lower than the test year amount. He testified that Atmos manages these costs from an overall cost perspective which results in costs that are both reasonable and necessary.[182] Mr. Knights testified that Mr. Pous' recommendation was not consistent in that he proposes a calendar average for Mid-Tex and an average of the last three rate cases for SSU.[183]

Examiners' Analysis and Recommendation

The evidence in the record indicates the relocation expenses during the test year are reasonable. There is no evidence which identifies any particular charge as unreasonable and or unnecessary. There is evidence that the costs and number of employees relocated vary from year to year. However, there is no evidence that the test year amount is higher than costs the utility is likely to incur going forward. The evidence indicates that Atmos will likely incur some level of relocation costs going forward in the future, but absent persuasive evidence that the test year amount is atypical, abnormal, or unreasonable, the Examiners do no see a reason to average this expense. The Examiners therefore recommend that the Commission approve Atmos' proposed test year level of relocation expense.

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177 Dallas Ex. 4, Pous Direct, p. 65.
178 Dallas Ex. 4, Pous Direct, p. 65.
179 Dallas Ex. 4, Pous Direct, p. 66.
180 Atmos Ex. 18, Knights Rebuttal, p. 24.
181 Atmos Ex. 18, Knights Rebuttal, p. 24.
182 Atmos Ex. 18, Knights Rebuttal, p. 25.
183 Atmos Ex. 18, Knights Rebuttal, p. 25.

L. Office Supply Expense

Dallas opposes Atmos' recovery of the test year amount for office supply expense. Mr. Pous testified that Atmos' office supply expense "is $323,155 or 77% higher than the last proceeding and $308,959 higher than GUD No. 9670."[184] He testified that most of the increase in costs is due to increases in employee development costs. Mr. Pous testified that Atmos has not explained "why a 217% increase in employee development cost since GUD No. 9762 is a reasonable and ongoing level of necessary expense."[185] He recommends that the account be averaged over three years and that the average be allowed as a recoverable expense.[186] The impact of Dallas' proposal is a $210,705 reduction in Atmos' recoverable expenses.

Mr. Knights testified that the Commission approved the test year amount for this account in both GUD Nos. 9670 and 9762. He testified that this expense is associated with employee training of administrative personnel which is necessary that these employees are trained in Atmos' systems.[187] He testified that Atmos has experienced an increase in employee training costs and that there is no reason to expect these costs to decrease.[188]

Examiners' Analysis and Recommendation

The evidence in the record indicates the office supply expenses during the test year are reasonable. There is no evidence which identifies any particular charge as unreasonable and or unnecessary. There is evidence that these costs vary from year to year. However, there is no evidence that the test year amount is higher than costs the utility is likely to incur going forward. The evidence indicates that Atmos will continue to incur these costs going forward, but absent evidence that the test year amount is atypical, abnormal, or unreasonable, the Examiners do not see a reason to average this expense. The Examiners therefore recommend that the Commission approve Atmos' proposed test year level of office supply expense.

VII. SHARED SERVICE UNIT EXPENSES

A. SSU Call Centers

Atmos has two call centers (Amarillo and Waco), which it operates to handle customer complaints and inquiries. The allocation of the call center costs was litigated in GUD Nos. 9670 and 9762, the two previous rate cases. The issue of how much of the costs to allocate from each call center to Atmos Mid-Tex was determined by the Commission in both of the two previous rate cases. In both dockets, it was determined that 100% of the Waco call center and zero of the Amarillo call

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184 Dallas Ex. 4, Pous Direct, p. 66.
185 Dallas Ex. 4, Pous Direct, p. 66.
186 Dallas Ex. 4, Pous Direct, p. 67.
187 Atmos Ex. 18, Knights Rebuttal, p. 27.
188 Atmos Ex. 18, Knights Rebuttal, p. 27.

center be allocated to Mid-Tex.[189] In this docket, Atmos allocated 100% of the costs associated with the Waco Call Center to Mid-Tex.[190] Consistent with the findings in GUD Nos. 9670 and 9762, no costs were allocated from the Amarillo call center to Mid-Tex.

Dallas acknowledges that Atmos has followed the Commission's order in allocation but alleges manipulation of costs to circumvent the Commission's order by changing practices, duties and personnel.[191] Dallas witness Jacob Pous testified Atmos created 13 new Shared Service Cost Centers, one of which (Cost Center 1158, Contact Center Information Technology) transferred $2.7 million previously assigned to call centers to this new cost center. The new cost center was assigned a lower capitalization ratio but was also allocated expenses to Mid-Tex using a higher percentage. Mr. Pous testified that Atmos transferred responsibility for multi-state, non-Mid Tex call coverage to the Waco Call Center as well as related personnel, thus changing the function of the Waco Call Center significantly.

Atmos does not dispute that costs were shifted from several existing cost centers to the newly created cost centers. Ms Myers (Atmos witness) testified "that there were cost centers created based on functions that were either preexisting and they were realigned and/or some functions also moved from Mid-Tex over to Shared Services."[192] Additionally, Atmos witness Jeffrey S. Knights stated there was a change effective May 2009, whereby the Amarillo call center changed its hours from a 24-hour call center to only being open from 6 AM to 9 PM 7-days a week. All calls between 9 PM and 6 AM are now diverted to the Waco call center.[193] Upon cross examination by Examiner LeMon, Mr. Knights admitted it was a known change but was not measurable at this time since the change only took place in May of this year.[194]

Dallas recommends the costs of the two call centers plus Cost Center 1158 "Contract Center Information Technology" be combined and allocated on a common basis using the 3ff allocation factor because of the changes in hours of operation for the Amarillo call center and the shift of costs into a common cost center and has suggested the allocation factor, 3ff.[195] Upon review of the Dallas proposal, Atmos' Mr. Knights objects to the allocation of call center costs to all Atmos utility divisions including Atmos Pipeline-Texas using a four factor allocation 3ff (plant, number of customers, O&M expenses and operating income) because the two call centers do not handle calls related to Atmos Pipeline-Texas. Atmos witness Barbara Myers disputed Dallas' recommended four factor allocation because the call centers functions are to serve the residential and commercial customers. However, Ms. Myers believes Atmos was correct in allocating none of the cost of the Amarillo call center and if the Commission were to decide both call centers should be allocated the correct allocation factor to use is rate 2. The effect of Dallas' recommendation is to reduce capital

189 GUD No. 9670, FOF 64 and GUD No. 9762, FOF 67.
190 Atmos WP_F-2.7, Cost Center 1210.
191 Dallas Pous witness Direct Testimony, page 43.
192 Volume Two Transcript of Hearing, 156: 11-14.
193 Knights Rebuttal, Page 7, footnote no. 1.
194 Volume Four Transcript of Hearing, 174: 5-11.
195 Dallas Pous witness Direct Testimony, page 44.

costs by $360,691 and an overall revenue requirement reduction of $2,871,721.

Examiner' Analysis and Recommendation

There are two proposals to be considered. One of allocation of the two call centers and Cost Center 1158 and, if so, what allocation factor to use. The Examiners find the argument raised by the City of Dallas to be a reasonably valid recommendation as it relates to the question of whether the Waco call center serves other divisions. This is particularly true based on Atmos witness Knights' statement that the 9 PM to 6 AM calls are diverted to Waco as of May 2009. This would be a known and measurable change. And, the line of reasoning that the call center should be allocated based on number of customers (Rate 2) reflects cost causation since the call centers only handle residential and commercial customers. However, the Examiners' find it difficult to recommend Dallas' proposal in its totality because allocating using the four factor 3ff is not reasonable as it does not reflect cost causation. The Examiners' recommendation is to accept the allocation of both the Waco and Amarillo call centers and Cost Center 1158 based upon the fact that it is a measurable change and recommend allocating the costs using Rate 2.

B. SSU Depreciation Expense

The City of Dallas has proposed making changes to the depreciation expense for three (3) sub-accounts. They are identified in the table below.

- Acct. 399.01 Servers – Hardware
- Acct. 399.02 Servers – Software
- Acct. 399.24 General Startup Costs

The City of Dallas recommends disallowing the depreciation expense in the cost of service for these three sub-accounts because they will be fully depreciated before the rates approved in this docket become effective.[196] Dallas witness Pous has identified other sub-accounts where the utility has fully accrued depreciation and is no longer seeking depreciation expense from its customers. Pous believes the same treatment should be applied to these three sub-accounts above.

Atmos contends the utility typically purchases one or two servers annually.[197] Therefore Account 399.01 would not necessarily be fully depreciated. Atmoss witness stated that Dallas erroneously used the 399.01 amortization rate for 399.02; after correcting the error, 399.02 will not be amortized in 2009. And, Atmos witness Dane Watson argues that the concept of traditional ratemaking is to take a "snap shot" in time. Atmos contends what the Dallas witness is doing is piece meal ratemaking.[198] Atmos does however, acknowledge that Account 399.24 would be fully

[196] Dallas Pous witness Direct Testimony, page 46.
[197] Atmos Witness Watson Rebuttal, page 7.
[198] Atmos Witness Watson Rebuttal, page 8.

depreciated at the time the rates approved in this docket become effective.[199]

Examiner' Analysis and Recommendation

Both Atmos and the City of Dallas work papers and schedules contained errors and miscalculations. This confusion resulted in testimony and rebuttal that required sorting out to assess first, whether the three accounts would in fact be fully depreciated at the time the rates in this docket become effective and second, if the City of Dallas recommendation had merit. After reviewing the evidence submitted, it is the Examiners' observation that these three accounts, if nothing else is purchased in the future, will be fully depreciated prior to the effective date of the rates approved in this docket. The Examiners note that Atmos made known and measurable changes from a June 30, 2008 test year to March 31, 2009 to 75% of its plant accounts. Atmos did not make additions to these three accounts in 21 months sufficient to increase the balances in these accounts to a point where they would not be fully depreciated. Based on the evidence, the Examiners recommend the depreciation expense of these three accounts be removed from the cost of service. The effect is a reduction to the revenue requirement of $2,744,900.

C. Capitalization Ratio change for 5 SSU Cost Centers

The City of Dallas has proposed changing the capitalization ratio for SSU cost centers 1162, 1408 and 1502 below from zero to 51.47%. Dallas' witness proposes a capitalization ratio of 13.955% for cost centers 1226 and 1228, both SSU. Dallas Witness Pous suggests that it is logical to conclude that the 5 cost centers provide services of review of the reasonableness and necessity of the overall capital expenditure budget and provide guidance to the overall direction of the company.[200]

Cost Center 1502 - Corporate Secretary
Cost Center 1162 - Benefits Accounting
Cost Center 1226 - Customer Service
Cost Center 1228 - Customer Revenue Management
Cost Center 1408 - Employee Development

Atmos contends that the only allocation appropriate is to allocate a portion of the expenses and no capital allocation.[201] Dallas also claims that there is no increase in overall costs, only the apportionment between capitalized and expensed amounts is modified. However, as Myers points out increasing the capital costs and not decreasing the expense allocation does not have a zero effect as Dallas alleged. Myers further points out that the utility conducted a study to determine capitalization of cost centers. These five cost centers' expenses should not be capitalized because the expenses can be directly assigned according to Myers.

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[199] *Id.* at 8
[200] Dallas Pous witness Direct Testimony, page 50.
[201] Atmos Witness Myers Rebuttal, pages 23 – 25.

Examiner' Analysis and Recommendation

The Examiners' find that Atmos' treatment of these five (5) SSU cost centers is consistent with the evidence in the record. The City of Dallas did not provide sufficient evidence that the cost centers should be capitalized.

D. SSU Allocation Factor Rate

Presently, Atmos allocates costs from eight (8) Shared Service Unit (SSU) cost centers based on an allocation factor Rate 2 or 49.18%.[202] The cost centers are:

Cost Center 1109 SS Dallas Payment Applications
Cost Center 1115 SS Dallas Billing Services
Cost Center 1148 SS Dallas Revenue System Support
Cost Center 1200 SS Customer Revenue Collections
Cost Center 1215 SS Dispatch Operations
Cost Center 1226 SS Dallas Customer Service
Cost Center 1227 SS Dallas Customer Program Management
Cost Center 1228 SS Dallas Customer Revenue Management

Dallas alleges that Atmos created the Rate 2 as a new allocation factor based on a customer only allocation and that it over-assigns costs to Texas. Dallas witness Pous suggests Atmos should allocate based on the utility's Rate 1ff, which allocates to the utility only operations, excluding Atmos Pipeline-Texas in instances where costs cannot be directly assigned. That factor incorporates gross property, average number of customers, total O&M expenses, and operating income to arrive at 45.12%.

Atmos witness Myers contends all of the above cost centers except one, Cost Center 1215, have been allocated in the same manner as approved in GUD No. 9762, using Rate 2. Cost Center 1215 was not because it was not a shared service cost center at the time of GUD No. 9762, it was a Mid-Tex direct cost center and, as a result, used a different allocation factor. Ms. Myers testified that these costs are driven by the number of customers.

Examiner' Analysis and Recommendation

Dallas' contention that Atmos *created* Rate 2 as a new allocation factor is unsubstantiated. The Examiners find that the utility has allocated seven of the eight cost centers in the same manner as was allocated in GUD No. 9762. Based on the evidence in the record, allocating the eighth cost center 1215 in the same manner is proper. The Examiners' therefore recommend Atmos' proposed allocation factor, Rate 2, be applied to these eight cost centers.

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[202] Dallas, Pous Direct Testimony, p. 52.

VIII. CAPITAL STRUCTURE AND RATE OF RETURN

A. Introduction

The Commission must establish the rate of return for Atmos to earn on the utility's rate base. In setting a gas utility's rates, the regulatory authority shall establish the utility's overall revenues at an amount that will permit the utility an opportunity to earn a reasonable return on the utility's invested capital used and useful in providing service to the public in excess of its reasonable and necessary operating expenses.[203] The regulatory authority may not establish a rate that yields more than a fair return on the adjusted value of the invested capital used and useful in providing service to the public.[204] Rate regulation is a balancing of competing interests, and we cannot focus solely on investor interests. In other words, what is required is a reasonable return, not an optimal return, on equity.[205]

As noted by the Austin Court of Appeals in *Railroad Commission of Texas v. Lone Star Gas Company*, to achieve the rate of return that a utility should be allowed to earn, the regulatory agency should consider the cost to the utility of its capital expressed as follows: (1) interest on long-term debt; (2) dividends on preferred stock; and (3) earnings on common stock.[206] As stated by the United States Supreme Court, the annual rate that will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties .... The return should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time, and become too high or too low by changes affecting opportunities for investment, the money market, and business conditions generally.[207]

The overall rate of return is usually calculated by determining the utility's weighted average cost of capital (WACC) which is the sum of the weighted cost of debt and return on equity. Regulated utilities have various sources of capital with which to finance operating assets: Issuance of common stock and preferred stock, long-term debt, and common equity. Preferred stock and short

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[203] TEX. UTIL. CODE ANN. § 104.051 (Vernon 2007 & Supp. 2008).

[204] TEX. UTIL. CODE ANN. § 104.052 (Vernon 2007 & Supp. 2008).

[205] *Mountain State Telephone Co. v. New Mexico State Corporation Commission*, 99 N.M. 1, 8, 653 P.2d 501 (1982).

[206] *Railroad Commission of Texas v. Lone Star Gas Company*, 599 S.W.2d 659 (Tex. App. — Austin 1980).

[207] *Bluefield Water Works and Improvements Co. v. Public Serv. Comm'n of West Virginia*, 262 U.S. 679 (1923), see also, *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1942).

term debt is sometimes included as a component for a calculation of the combined return. Atmos has proposed using two components for determining its WACC: Cost of Debt and Cost of Common Equity. The Commission approved the use of Cost of Debt and Cost of Common Equity as the two components for calculating Atmos' WACC in GUD No. 9762.

B. Capital Structure

Atmos witness Laurie M. Sherwood testified on the company's proposed capital structure.[208] Atmos proposes using the consolidated capital structure for Atmos Energy as a whole.[209] Ms. Sherwood calculated the utility's capital structure to be composed of 51.09% long-term debt and 48.91% common equity on December 31, 2008, and adjusted for known and measurable changes.[210] Ms. Sherwood adjusted the capital structure as a result of Atmos' issuance of $450 million of new long-term debt in March 2009 and the April 30, 2009 redemption of $400 million of maturing long-term debt.[211] Staff witness Frank Tomicek testified that Atmos' proposed capital structure is consistent with the Commission's decision in GUD No. 9762. Mr. Tomicek testified that "Staff believes that the capital structure proposed by the Company is appropriate in this proceeding."[212] Dr. Eugenio J. Miravete testified on behalf of the State on Atmos' proposals for rate of return and does not challenge Atmos' proposed capital structure.[213]

The expert witness for Dallas disputes Atmos' proposed capital structure. David C. Parcell testified on behalf of Dallas on Atmos' proposals for rate of return and capital structure.[214] During the Final Hearing of this matter, Mr. Parcell updated his capital structure proposal at the final hearing. Mr. Parcell testifies that Atmos' actual capital structure as of December 31, 2008, was 50.50% long-term debt and 49.50% common equity.[215] Mr. Parcell testified that he originally used the capital structure data from Ms. Sherwood's testimony, which is pro forma data and not the actual data. He testified that this correction actually increases the cost of capital two basis points.[216]

Examiners' Analysis and Recommendation

The Examiners find that the use of Atmos' actual capital structure adjusted for known and measurable changes as of December 31, 2008, is reasonable, supported by the evidence in this proceeding, and is consistent with the Commission's final decision in GUD No. 9672. Adjusting Atmos' capital structure for a March debt issuance and an April bond redemption is a known and measurable change and is reasonable. These financial transactions were known by the utility and

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208 Atmos Ex. 9, Sherwood Direct.
209 Atmos Ex. 9, Sherwood Direct p. 7.
210 Atmos Ex. 9, Sherwood Direct p. 10.
211 Atmos Ex. 9, Sherwood Direct p. 9-10.
212 Staff Ex. 1, Tomicek Direct p. 4.
213 State Ex. 1, Miravete Direct.
214 Dallas Ex. 3, Parcell Direct.
215 Tr. p.88.
216 Tr. p.91, ln. 18-23, p. 118-119

incorporating them in the rates is reasonable because it results in a capital structure calculation that is more likely to resemble the company's capital structure going forward under the rates set in this proceeding. Dallas' witness testimony does not establish that this adjustment is not warranted and does not establish how or why this proposed capital structure is not accurate or reasonable.

C. Cost of Debt

Atmos proposes using a weighted average cost of debt of 6.88%. Ms. Sherwood testified that she calculated Atmos' weighted average cost of long-term debt to be 6.98%, which she subsequently has updated to 6.88%.[217] She testified that this level of weighted average cost of debt is appropriate in order to permit Atmos Energy to raise the debt capital required to support its operations and to continue to provide gas service.[218] Staff witness Mr. Tomicek testified that Atmos' proposed cost of debt of 6.88% is consistent "with the Commission's stance to use actual financial performance results when available, accurate, and reasonable, Staff accepts this as the cost of debt for the Company."[219] Dr. Miravete does not give an opinion on Atmos' proposed cost of debt.[220]

Dallas opposes Atmos' weighted average cost of debt. Mr. Parcell testified that Atmos' actual embedded cost rate of long-term debt is 6.10%.[221] In its briefing Dallas argues that Atmos' cost of debt is based upon financing closed on March 26, 2009, which nine months after the Dallas City Council took action on Atmos' underlying statement of intent; that this resulted in increased debt costs because the debt was financed at the extreme of the market; and that the adjusted cost of debt was not known and measurable.[222]

Examiners' Analysis and Recommendation

The Examiners find that the use of Atmos' proposed cost of long-term debt at the level of 6.88% is reasonable. There is not sufficient testimony or evidence to support Mr. Parcell's brief testimony that the actual cost of debt for Atmos is 6.10%. Commission Staff support a 6.88% cost of debt in their testimony and briefing on this issue. The testimony submitted by Ms. Sherwood supports a cost of debt of 6.88%. She submitted data and supporting calculations which support this level of debt cost. There is not sufficient evidence to rebut her testimony and evidence on this issue as Mr. Parcell's testimony does not indicate how he arrived at a 6.10% cost of long-term debt. The Examiners recommend that the Commission find that a 6.88% weighted average cost of long-term debt is reasonable in this case.

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217 Atmos Ex. 9, Sherwood Direct p. 11-12., Atmos Ex. 16, Sherwood Rebuttal p. 8
218 Atmos Ex. 9, Sherwood Direct p. 11.
219 Staff Ex. 1, Tomicek Direct p. 4.
220 State Ex. 1, Miravete Direct.
221 Dallas Ex. 3, Parcell Direct p. 25.
222 Dallas *Initial Brief* at p. 15.

D. Cost of Equity

The cost of equity component of a utility's weighted average cost of capital is usually the most contested aspect of setting an appropriate rate of return. The cost of equity is not readily measurable, is based upon the interpretation of financial and market data, and is subjective by nature. In this docket Atmos' expert witness utilized three methods to estimate Atmos' cost of equity: (1) the discounted cash flow method (DCF); (2) the risk premium method (RP); and (3) the Capital Asset Pricing Model method (CAPM).[223] All intervenors submitted testimony and challenged certain aspects of Atmos' cost of equity determination.

1. DCF Analysis

The DCF is a widely used method to analyze the cost of common equity. The DCF model assumes that investors value an asset on the basis of the future cash flows they expect to receive from owning the asset, and that due to the time value of money current dollars are more valuable than future dollars.[224] The general DCF model is the following: $K = D/P + g$. Where: K is the cost of common equity; D is the dividend per share; P is the price per share; and g is the rate of growth of dividends or common stock earning. The DCF attempts to quantify a market-based value of common equity based on the present value of a stream of returns. While this formula appears relatively straightforward, the variables and assumptions underlying the calculation are subject to interpretation which gives rise to debate. Dr. Vander Weide recommended that the DCF model account for the quarterly payment of dividends.[225] He also testified that all companies in his proxy group paid dividends on a quarterly basis. He testified that the quarterly dividend version of the DCF model is more appropriate because it most accurately reflects the timing of dividend payments. He also included an adjustment for flotation costs.[226] Dr. Vander Weide calculated a cost of equity of 11.5 percent using the DCF model he proposes.

All intervening parties challenged aspects of Dr. Vander Weide's DCF analysis. The first general area of disagreement was Dr. Vander Weide's proposed use of the quarterly dividend version of this method. All intervening parties opposed Dr. Vander Weide's quarterly DCF model and recommended using an annual DCF approach. State's witness Dr. Miravete testified that the Commission's 2007 Natural Gas Rate Review Handbook does not contemplate the use of a quarterly version of the DCF method.[227] He testified that the quarterly version of the DCF model will overestimate the cost of equity for any given total dividend amount in a given year.[228] Dr. Miravete calculated that the quarterly version exceeds the annual version by 40 basis points.[229] Staff's witness Mr. Tomicek testified that the quarterly version of the DCF model has not been used in any prior

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[223] Atmos Ex. 10, Vander Weide Direct, p. 17.
[224] *Id.* at 18.
[225] *Id.* at 20-22.
[226] *Id.* at 27-29.
[227] *Id.* at 14.
[228] State Ex. 1, Miravete Direct, p. 14.
[229] *Id.* at 17.

Commission rate cases. He also testified that the quarterly DCF model "overstates the cost of equity for ratemaking because of the addition of extra compounded returns."[230] He testified that the quarterly DCF model assumes that quarterly dividends are re-invested to earn additional returns.[231] Dallas's witness Mr. Parcell uses the annual DCF model in his cost of equity estimates.[232]

The second area challenged by intervenors was Dr. Vander Weide's selection of proxy group companies. Staff's witness Mr. Tomicek testified that four companies should be eliminated from Dr. Vander Weide's proxy group: Energen, EQT, ONEOK, and Questar.[233] He testified that Energen, EQT and Questar received the greater portion of their revenues from upstream oil and gas production operations, and that ONEOK receives most of its revenues from pipeline transportation. He testified that these companies have a "significantly different business risk profile" from companies that generate revenues primarily from gas distribution operations.[234] Dr. Miravete utilizes the same companies selected by Dr. Vander Weide in his proxy group for calculating his recommended cost of equity.[235] However, he criticizes the choice of companies and testified that several should not have been included because their primary business activity is not gas distribution.[236] He determined that Energen, EQT, NiSource, ONEOK, and Questar do not engage in gas distribution as their primary business activity and it is not appropriate to include these firms in the proxy group.[237] Dr. Miravete also opposes including Atmos Energy in the proxy group because this introduces a "circularity problem as the Thomson Reuter's expectation of the future earning per share of Atmos ends up determining the actual ROE of Atmos."[238] Mr. Parcell testified that he used different selection criteria for the companies in the proxy group he developed. He testified that several of Dr. Vander Weide's companies did not meet his selection criteria, including Energen, EQT, NiSource, ONEOK and Questar.[239]

A third challenge to the DCF model involves the inclusion of flotation costs. Dr. Vander Weide testified that all firms that sell securities incur flotation costs and that in general these costs range in between three and five percent. Dallas and the State oppose Dr. Vander Weide's inclusion of a flotation cost adjustment to his DCF model. Mr. Parcell testified that Dr. Vander Weide's "5 percent flotation cost adjustment overstates the cost of equity."[240] Dr. Miravete criticizes the inclusion of flotation costs as inappropriate. He testifies that removing flotation costs reduces the cost of equity by 20 basis points.[241] Dr. Miravete testified that the Rate Review Handbook of the Commission states that flotation costs are not contemplated "since it is likely that the dilution to

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230 Staff Ex. 1, Tomicek Direct, p. 9.
231 *Id.* at 9.
232 Dallas Ex. 3, Parcell Direct, p. 27.
233 Staff Ex. 1, Tomicek Direct, p. 6.
234 *Id.* at 6-7.
235 *Id.* at 19-20.
236 *Id.* at 19-20.
237 *Id.* at 19-20.
238 *Id.* at 13.
239 Dallas Ex. 3, Parcell Direct, p. 25, 26 and Schedule 9.
240 *Id.* at 49.
241 State Ex. 1, Miravete Direct, p. 18.

existing stockholders' equity from such costs is inconsequential."[242]

Dallas opposes Dr. Vander Weide's growth rate. Dr. Vander Weide used the analysts' estimates of future earning per share (EPS) growth reported by I/B/E/S Thomson Reuters.[243] Mr. Parcell considered five indicators of growth in the DCF analysis he prepared.[244]

Examiners' Analysis and Recommendation

The first area of contention concerning Dr. Vander Weide's DCF analysis is the use of a quarterly dividend DCF model. The evidence submitted establishes that Atmos Energy and the companies in all expert witnesses' proxy groups pay dividends on a quarterly basis. The DCF model essentially calculates a present value of the cash flows an investor may receive from owning a particular equity. Dr. Vander Weide used a quarterly model because he argues that it more accurately represents the actual cash flow streams of utility stocks in the proxy group, including Atmos. The intervenors argue that it is inappropriate to use because it will overstate the cost of equity. The intervenors arguments against the quarterly dividend model are essentially that the result is not appropriate for ratemaking purposes. The Examiners are unaware of a quarterly DCF model being used in any prior rate cases before the Commission. However, if dividend payments are paid on a quarterly basis it is logical to conclude that a mathematical model that values quarterly payments is reasonable. There is no credible or persuasive evidence that establishes that a model which accounts for the actual cash flow streams of proxy companies is somehow unreasonable as compared to a model that inaccurately represents those same cash flow streams. The Examiners recommend that the Commission find that it is reasonable for Atmos to use a quarterly DCF model as one method to establish an appropriate cost of equity.

The second area of contention concerns Dr. Vander Weide's proxy group selection. Intervenor witnesses challenged Dr. Vander Weide's inclusion of Energen, EQT, ONEOK, and Questar in the proxy groups. The primary reason for exclusion is that these companies receive a greater portion of their revenues from upstream oil and gas production or pipeline transportation. Dr. Vander Weide discusses how a company's risk is the primary determinant of inclusion or exclusion from the proxy group. He essentially defines risk in terms of the company's statistical share price performance. The intervenor witness testimony focuses on the business risk by discussing that how the above companies engage in other business activities and hence incur different business risks than Atmos as a gas distribution company. The Examiners find that it was unreasonable for Dr. Vander Weide to include these four companies in the proxy group of companies because of the higher percentage of revenues earned from non-gas distribution activities.

The third area of contention is the inclusion of flotation costs in the models used by Dr.

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[242] *Id.* at 17.
[243] Atmos Ex. 10, Vander Weide Direct, p. 23
[244] Dallas Ex.3, Parcell Direct, p. 29.

Vander Weide. The Commission has not historically allowed for the inclusion of flotation costs in determining a utility's cost of equity. Whether or not to allow such a factor is a policy decision. The Examiners do not recommend that the Commission approve the inclusion of flotation costs. The Examiners do not find that Atmos has clearly established that the inclusion of an estimation of these costs is necessary, reasonable and required to set a reasonable rate of return for the utility. There is no clearly established evidence that the flotation costs affect the opinions of investors due to the dilution factor referred to in the Rate Review Handbook. Therefore the Examiners recommend that the Commission deny Atmos' request to account for flotation costs in its DCF methodology used to estimate the cost of equity component of its weighted average cost of capital.

The fourth area of contention is Dr. Vander Weide's proposed growth rate to his DCF model. Dr. Vander Weide used analysts forecasts of projections of future EPS growth as his growth rate and has co-authored a study concluding that analysts projections of earnings per share ("EPS") growth are the best estimate of investors' expectation of future long-term growth. Arguments against using estimates of future EPS growth are that its not realistic to conclude that investors exclusively rely on analyst estimates; most data that investors rely on is essentially historical data; the forecasts are inaccurate, overly-optimistic, and have been shown to have been biased. Ratemaking is traditionally based on historical data. In this docket, Dr. Vander Weide cites some compelling reasons why analysts future estimates of EPS growth are relied upon by investors when making decisions. However, there is no evidence in the record that establishes that analyst estimates of EPS growth for the individual companies used in the proxy studies by Dr. Vander Weide and the other witnesses is reliable, accurate, and capable of forecasting the future EPS growth of these specific companies with any reliability. Therefore the Examiners recommend that the Commission not approve Dr. Vander Weide's proposed growth rate.

DCF Results Summary

Atmos: Vander Weide - DCF	Staff: Tomicek - DCF	Dallas: Parcell - DCF	State: Miravete-DCF	Mid-Point
11.5 percent	8.74 - 11.68 percent	9.2 - 10.3 percent	9.9 percent	10.21

2. CAPM Analysis

The CAPM is an equilibrium model of the markets in which the required return of a security is equal to the risk-free rate of interest, plus the company equity beta time the market risk premium. The CAPM is simply expressed in a formula as: $K = Rf + \beta \times RP$. Where: K is the estimated rate of return of the stock; β is the measure of a company's risk relative to the market as a whole; and Rf is the risk free rate of interest; and RP is a risk premium. Dr. Vander Weide used the forecasted yield to maturity on 20-year treasury bonds of 4.80% as the risk free rate.[245] He estimated the risk premium on the market portfolio from the difference between the DCF cost of equity for the S&P 500 and the yield to maturity on 20-year Treasury bonds. He calculated a risk premium equal to

[245] Atmos Ex. 10, Vander Weide Direct, p. 40-43.

8.6%.[246]

Dr. Vander Weide's use of the 20-year Treasury bond as the risk free rate was challenged. Mr. Tomicek uses the 10-year Treasury bond for the risk free rate in his CAPM study. He calculated a maximum CAPM-derived cost of equity estimate of 8.52%.[247] State's witness testified that Dr. Vander Weide inappropriately uses the 20-year Treasury bond for the risk-free rate.[248] Dr. Miravete testified that it is inappropriate to use the forecasted 20-year rate instead of the actual 10-year rate. Dallas witness Mr. Parcell also testified against Dr. Vander Weide's CAPM methodology. Mr. Parcell used a 20-year Treasury bond rate but derived a different cost of equity from his CAPM model. He testified that the CAPM cost of equity for Atmos is 7.6 to 7.8 percent.[249]

Examiners' Analysis and Recommendation

One of the main problems of the CAPM methodology is the validity of the results. The CAPM model is based on the premise that investors demand a return on equity that is greater than a risk free return and which is sufficient to account for the inherent risk involved with an equity investment. The CAPM study performed by Mr. Parcell resulted in a cost of equity less than the cost of debt recently issued by Atmos.[250] Mr. Tomicek's CAPM resulted in a mean cost of equity of 9.06, which is approximately 56 basis points higher than Atmos' recently issued 10-year notes.[251] Dr. Miravete calculated a 9.17 percent CAPM result, which is 67 basis points above Atmos' recent 10-year note issuance.

The main issue of contention with Dr. Vander Weide's CAPM was his use of the 20-year Treasury bond as the risk free rate. Mr. Parcell used a 20-year bond in his CAPM analysis. Atmos argues that it is appropriate to use a 20-year bond for determining the risk free interest rate because it is a long-term instrument with a length of maturity that is similar to the utility's length of investment in plant, equipment and pipe. The Examiners agree and find that Dr. Vander Weide's using a bond with a twenty year maturity is reasonable for ratemaking purposes and will not allow Atmos to earn an unreasonable return on its investment. Dr. Miravete challenged Dr. Vander Weide's use of the forecasted return of the twenty year bond and that it is more appropriate to use the current yield of the bond. We agree and recommend that the Commission find that the use of a forecasted yield on the twenty year Treasury bond is unreasonable for rate-rate making purposes. There is no evidence in the record that the forecasted yield of the 20-year Treasury bond is reasonable, reliable or accurate. Dr. Miravete testified that the use of the current bond yield (3.83% as of February 2009, as opposed to the forecasted 4.80%) results in a CAPM estimate of 10.13 percent. Mr. Parcell testified that his CAPM results were not reliable. Discarding Mr. Parcell's CAPM results, the midpoint of the CAPM studies conducted is 10.93 percent, including his CAPM

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246 *Id.* at 41.
247 Staff Ex.1, Tomicek Direct, p. 12.
248 State Ex. 1, Miravete Direct, p. 24-27.
249 Dallas Ex. 3, Parcell Direct, p. 34.
250 Atmos Ex. 17, Vander Weide Rebuttal, p. 22.
251 *Id.* at 22.

results it is 10.3 percent.

CAPM Results Summary

Atmos: Vander Weide - CAPM	Atmos: Vander Weide - DCF CAPM	Staff: Tomicek - CAPM	Dallas: Parcell - CAPM	State: Miravete-CAPM	Mid-Point - excluding / including Parcell Results
11.1 percent	12.8 percent	9.06 percent	7.8 percent	9.17 percent	10.93 / 10.3

3. Risk Premium Analysis

The risk premium analysis is based on the theory that investors expect to earn a return on equity investment in Atmos that reflects a premium over and above the return they expect on a portfolio of bonds. The premium is to compensate for the additional risks associated with equity investments.[252] Dr. Vander Weide used two methods to estimate the required risk premium: (1) the *ex ante* risk premium method; and (2) the *ex post* risk premium method.[253] Dr. Vander Weide based his ex ante risk premium method on the DCF expected return for his proxy group compared to the interest rate on Moody's A-rated utility bonds. Dr. Vander Weide calculated an ex ante risk premium of 4.8 percent, which when added to the 6.3 percent average yield to maturity of A-rated utility bonds results in a cost of equity of 11.1 percent.[254] Dr. Vander Weide created his ex post risk premium by comparing the average returns received by equity investors to the average returns received by bond investors over the last 72 years.[255] Dr. Vander Weide testified that his ex post study indicates that investors today require an equity return of approximately 4.2 to 4.5 percentage points above the expected yield on A-rated utility bonds.[256] Using an expected yield of 6.3 percent he calculated a cost of equity range of 10.5 to 10.8 percent using the ex post risk premium methodology.[257]

State witness Dr. Miravete testified that Dr. Vander Weide's ex ante risk premium method did not include sufficient information to evaluate whether his econometric was reliable.[258] He recommends that the Commission ignore Dr. Vander Weide's ex ante risk premium approach. Dr. Miravete testified that the ex post risk premium approach is inappropriate because it is backward looking.[259] He also testified that the ex post risk premium study did not have sufficient statistical information to establish that it was a reliable study and he recommends that the Commission ignore this study as well.[260] Mr. Parcell testified that Dr. Vander Weide's use of the quarterly DCF model

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[252] Atmos Ex. 10, Vander Weide Direct, p. 31.
[253] *Id.* at 32.
[254] *Id.* at 32-34.
[255] *Id.* at 34-37.
[256] *Id.* at 39-40.
[257] Atmos Ex. 10, Vander Weide Direct, p. 40.
[258] State Ex. 1, Miravete Direct, p. 21-23.
[259] *Id.* at 23.
[260] *Id.* at 23-24.

and flotation cost adjustment overstates the risk premium in the ex ante model and that the ex post model has inconsistencies.[261]

Examiners' Analysis and Recommendation

Atmos' witness performed two risk premium studies. Dr. Vander Weide's ex ante method compares the DCF expected return of the proxy group to the interest rate paid on Moody's A rated bonds. The ex post method compares the average returns received by equity investors to average returns received by bond investors over the last 72 years.[262]

The results of Dr. Vander Weide's risk premium studies are in line with other methods to determine the utility's cost of equity. There is not sufficient evidence in the record that leads the Examiners to conclude that Dr. Vander Weide's risk premium studies are inherently flawed, unreasonable or inappropriate for rate-making purposes. Dr. Miravete alleges that there are not sufficient statistical data to use the ex ante risk premium method and that it should be ignored. Dr. Vander Weide's workpapers contained statistical data to assess the reliability of the ex ante and ex post studies. Mr. Parcells objected to the use of the quarterly DCF study and future analyst growth rate estimates in the ex ante study. We agree that the use of analysts estimated future EPS growth rates is not appropriate because of the lack of evidence as to the accuracy of the forecasts. We disagree that a quarterly DCF model is unreasonable. Mr. Parcells objected to the validity and applicability of the ex post model. We find that the ex post risk premium model is a valid tool to analyze the historical requirements of investors. Except for the use of forecasted EPS growth rates, we find that the evidence in the record does not clearly establish that Dr. Vander Weide's ex ante risk premium and ex post risk premium models are unreasonable, invalid or inappropriate for use in estimating the cost of equity for Atmos. It is also reasonable to use these tools to gain additional data on what a reasonable cost of equity may be for rate-making purposes. The Examiners find that it was reasonable for Atmos' witness to conduct risk premium studies as an additional tool to analyze an appropriate cost of equity for the utility.

Risk Premium Results Summary

Atmos: Vander Weide - ex ante risk premium	Atmos: Vander Weide - ex post risk premium	Mid-Point
11.1 percent	10.9 percent	11.0

4. Overall Cost of Equity

All witnesses performed multiple studies to estimate a cost of equity for Atmos in this docket. Dr. Vander Weide performed five different studies, and determined a cost of equity range of between 10.9 percent and 12.8 percent. Based on these he recommends a cost of equity of 11.5

261 Dallas Ex. 3, Parcell Direct, p. 49-50.

262 Atmos, *Initial Brief of Atmos Energy Corp., Mid-Tex Division*, at 23.

percent.[263] Mr. Parcell performed three studies and based on these he recommends a cost of equity of 9.8 percent.[264] Dr. Miravete performed two studies which he used to recommend an cost of equity of 9.25 percent.[265] He calculated an average cost of equity of 9.5 percent but recommends reducing that by 25 basis points due to the availability of GRIP which he testified lowers Atmos' risk.[266] Mr. Tomicek performed two studies and recommends that the cost of equity be capped at 10.4 percent.[267] The Examiners find that, with the exception of a few aspects of Dr. Vander Weide's cost of equity studies, that the cost of equity analyses provided by the parties are reasonable and demonstrate that a cost of equity in the range of 9.2 percent through 11.68 percent is probably reasonable. Mr. Tomicek recommended that the Commission not approve a cost of equity no greater than 10.4 percent. We agree. The Examiners recommend that the Commission use 10.0 percent as the cost of equity for determining Atmos' overall rate of return in this proceeding. This amount is in the range of reasonable amounts for a cost of equity, and the Commission has recently approved 10 percent as a reasonable cost of equity.[268]

Cost of Equity Recommendation Summary

Atmos: Vander Weide	Staff: Tomicek	Dallas: Parcell	State: Miravete	Examiners
11.5 percent	10.4 percent Max	9.8 percent	9.25 percent	10.0 percent

5. Overall Rate of Return

The Examiners recommend using a cost of equity of 10.0 percent which yields an overall rate of return for Atmos of 8.41 percent. The following table summarizes the recommended rates of return recommended by the parties using the actual capital structure, a 6.88 percent cost of debt, and the parties' recommended cost of equity.

Summary of Overall Rate of Return Recommendations

Atmos	Staff	Dallas	State	Examiners
9.14 percent	8.65 percent Max	8.31 percent	8.04 percent	8.41 percent

The Examiners recommend that the Commission approve 8.41 percent as a reasonable rate of return for Atmos in this proceeding.

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263 *Id.* at 5.
264 Dallas Ex. 3, Parecell Direct, p. 40.
265 State Ex. 1, Miravete Direct, p. 28.
266 *Id.* at 29.
267 Staff Ex. 1, Tomicek Direct, p. 15.
268 *See* GUD No. 9791.

IX. RATE DESIGN

A. Proposed Customer Charges

At issue among the parties is not the manner in which the rates were allocated among the customer classes rather how much the customer charge should be. Once the customer charge is determined, the commodity charge will be adjusted accordingly to recover the revenue requirement. Atmos has proposed an increase in both the monthly customer charge and commodity charge for residential and commercial customers. For the industrial and transportation customers, Atmos has proposed an increase in the customer, or meter charge, and a decrease in the commodity charges. The table below shows the proposed increases by customer class.

Proposed Rates			
	Residential	Commercial	I & T
Proposed Monthly Customer Charge	$ 16.00	$ 30.00	$ 550.00
Proposed Commodity Charge	$ 0.6756 / Mcf	$ 0.6739 / Mcf	$ 0.1923 / 1st 1,500 MMBtu $ 0.1399 / next 3,500 MMBtu $ 0.0223 / over 5,000 MMBtu

The following table identifies the existing rates authorized in GUD No. 9762 and the current Interim Rate Adjustment currently being charged in the City of Dallas and in the Environs.[269]

Existing Rates			
	Residential	Commercial	I & T
Monthly Customer Charge – GUD No. 9762	$ 14.00	$ 25.00	$ 450.00
IRA Charge	$ 0.47	$ 1.23	$ 23.06
Total Current Customer Charge	**$ 14.47**	**$ 26.23**	**$ 473.06**
Commodity Charge	$ 0.6164 / Mcf	$ 0.6109 / Mcf	$ 0.2200 / 1st 1,500 MMBtu $ 0.1600 / next 3,500 MMBtu $ 0.0255 / over 5,000 MMBtu

Atmos claims the rate design has been done in the same manner as was done and approved in GUD No. 9762.[270] As a result of criticism of the increase in customer charges, Atmos completed a class cost of service study for rebuttal.[271] Atmos' study showed fixed costs per customer per month for residential customers to be $18.35, $46.81 for commercial and

[269] The City of Dallas denied the IRA rate and GUD NO. 9802 authorized the rates in the Environs.
[270] Atmos witness Gary L. Smith Direct Testimony, page 27.
[271] Atmos witness Gary L. Smith Exhibit GLS-R-2.

$528.78 for industrial and transportation. Mr. Smith developed the study using the same classifications used by the class cost of service study approved in GUD No. 9762. For example, any cost the Commission determined to be allocated on a customer basis were deemed customer related costs, such as service investments. Any costs the Commission determined to be allocated on a demand basis were deemed demand related costs, such as mains investments. And finally, since the Commission has determined distribution load dispatching operations and maintenance expenses should be allocated on the basis of throughput, they were classified as commodity related costs.[272]

The City of Dallas contends increasing the customer charge typically cause intraclass subsidies, as higher customer charges reduce charges based on a customer's usage.[273] The City of Dallas recommends the customer charges be no higher than $14.00 for residential, $25.00 for commercial and $475.00 for industrial and transportation, inclusive of the disputed Interim Rate Adjustment charges.[274] Additionally, the City of Dallas claims the evidence is clear that the proposed increase in customer charges will be among the highest in the State.[275]

The State of Texas recommends rejection of the proposed Commercial and Industrial customer charges and recommends the Commission adopt the customer charges for Commercial and Industrial as that adopted in GUD No. 9770.[276] The basis of the State's recommendation rests on the dramatic increase in the rates from GUD No. 9400.[277]

The commodity charge, the rate per Mcf charged to the customer, is a calculation that results from the cost of service revenue requirements after the customer charge is determined. In other words, once the customer charge is determined, Atmos is requesting a change in the customer charges for each class of customer served which is discussed above, the commodity charge is a mathematical result of what is needed to meet Atmos' revenue requirement. Atmos is requesting a revenue requirement of $432,206,870 and customer charges of $16, $30 and $550 for residential, commercial and Industrial and transportation, respectively. If the revenue requirement is approved as requested, the resulting commodity charge will be $0.6759 per Mcf, $0.6740 per Mcf and a tiered rate structure per MMBtu of $0.1924 for the first 1,500 MMBtu, $0.1399 for the next 3,500 MMBtu, and $0.0223 for volumes over 5,000 MMBtu, for residential, commercial and industrial and transportation, respectively.

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[272] Atmos witness Gary L. Smith Rebuttal, page 20.
[273] City of Dallas witness Michael J. McFadden Direct Testimony, page 22.
[274] The City of Dallas has denied the Interim Rate Adjustments sought by Atmos.
[275] City of Dallas Reply Brief.
[276] GUD No. 9770 is an appeal of Texas Gas Service Company from the actions of the cities of Lockhart, Lulling, Cuero, Gonzales, Nixon, Shiner and Yoakum and Statement of Intent of Texas Gas Service Company to increase rates in the unincorporated areas of the South Texas service area.
[277] In GUD No. 9400, the Commission approved a $15 customer charge for Commercial and a $150 customer charge for industrial.

Examiner' Analysis and Recommendation

The examiners do not find compelling evidence from the intervenors to recommend denying Atmos the changes in customer charges. The Examiners note arguments have been made throughout the industry in published articles both for and against higher customer charges stating the same argument as Dallas, intraclass subsidies for opposition and the move toward rate de-coupling supporting the higher customer charges. The City of Dallas did not challenge the methodology Atmos took to arrive at its calculations to determine the customer charges. Dallas only claims they are unreasonable. The State of Texas only points to the dramatic increase from prior Mid-Tex cases. Neither party argues an inappropriate methodology in Atmos' calculations or challenges the percentage of recovery of fixed cost through the customer charge. As a result, the Examiners recommend the proposed customer charges of $16.00 for Residential, $30.00 for Commercial and $550.00 for Industrial and Transportation by Atmos be approved. If the Commission accepts the all of the Examiners' recommendations, the revenue requirement will be $410,714,256. That will result in commodity charges of $0.4846 per Mcf for Residential, $0.6031 per Mcf for Commercial, and a tiered rate structure for Industrial and Transportation per MMBtu of $$0.1692 for the first 1,500 MMBtu, $0.1230 for the next 3,500 MMBtu and $0.0196 for all over 5,000 MMBtu.

B. Billing Determinants

The billing determinants are representative of the billing units expected to occur when the new rates are put into effect. They are the factors upon which a utility bills its customers. Therefore, the billing determinants are the number of customers, or bills, to which the customer charge is applied and the volumes of gas delivered to the customer's meters. The development of the billing determinants is critical for determining both the revenues under current rates for the revenue deficiency and development of the proposed rate structure to meet the utility's revenue needs.

There are several issues regarding the development of the billing determinants. First, Dallas' witness Michael J. McFadden suggests the billing determinants was not updated thru March 31, 2009.[278] However, if the Commission determines that rate base should only include gross plant through December 31, 2008, this becomes an issue of using the December 31, 2008 billing determinants rather than March 31, 2009 data. Second, the issue is whether Atmos should use an adjustment for determining the appropriate number of customers representing a reduction for future growth. Third, whether Atmos should use an adjustment for declining sales volumes. Fourth, whether the utility used a 10-year analysis of normalized sales volumes or a 30-year analysis. According to Atmos' witness Gary L. Smith, the billing determinant study was updated thru March 31, 2009.[279]

Customer Growth Adjustment: Atmos determined that current economic conditions warrant

[278] City of Dallas Michael J. McFadden Testimony page 3.
[279] Atmos witness Gary L. Smith Rebuttal Testimony, page 16 and Billing Determinant Study in the Errata filing on August 4, 2009.

an adjustment for residential customer growth. After discussing the projected future of customer growth with the Mid-Tex Marketing staff, Atmos made an "Economic Adjustment" which effectively zeros out the customer growth calculation.[280] Specifically, the Mid-Tex marketing staff believes new home construction is slowing and there is an increased risk in termination of existing customers due to economic conditions.[281]

The City of Dallas witness Michael J. McFadden opposes this "Economic Adjustment" as having little evidence to support the adjustment. Based upon his calculations, the number of customers between June 2008 and February 2009 shows as an increase of 121,574 with the downward adjustment and an increase of 45,309 customers without the adjustment.[282] According to Dallas' witness Mr. McFadden, there is no evidence to show a decline in the number of customers for a future period. In the errata filed, Atmos removed the customer adjustment, making this a non-issue[283].

Volumetric Adjustment: Atmos claims a decline in sales volumes based on a 10-year study from 1998 – 2007 of 0.84 Mcf per year.[284] Given the data, Atmos has reflected the declining volumes residential usage by including a 0.7 Mcf decline from normalized volumes, or an adjustment to residential volumes of 1,008,374. Atmos calculated the volume decline by multiplying 0.7 Mcf times the projected number of customers.[285]

Dallas' witness Mr. McFadden filed testimony that disputes Atmos' calculations by saying first, if one was to calculate a declining usage adjustment it wouldn't be on the projected number of customers, it would be on the actual number of customers. Mr. McFadden claims this overstates the declining usage if one was to agree that it is proper to allow such a deduction. Additionally, the City of Dallas claims this deduction is essentially an attrition adjustment, not supported by the Commission's Rate Handbook.[286] The usage adjustment attempts to offset an anticipated decline in revenue caused by a potential decline in usage subsequent to the end of the test year.[287] Dallas' McFadden noted that Atmos did not make the same adjustment to the Commercial Class. Finally, the City of Dallas witness points out that if the Commission were to allow a declining usage adjustment, it should also include the anticipated customer growth in customer beyond[288] the end of the test year, something Atmos did not do.

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[280] Atmos witness Gary L. Smith Direct Testimony, page 16.
[281] *Id*
[282] Exhibit MJM-3.
[283] Atmos witness Gary L. Smith Rebuttal Testimony, page 14.
[284] Atmos Gary L. Smith Direct Testimony, page 17.
[285] BDS 1-2.
[286] City of Dallas witness Michael J. McFadden Direct Testimony, page 12.
[287] *Id*
[288] *Id*

Weather Adjustment: The City of Dallas alleges that something is wrong with the errata weather adjustment as of Mach 31, 2009.[289] The city of Dallas contends the "normalized" weather data used by Atmos artificially suppresses the revenues. The State of Texas proposes that Atmos has made a further adjustment by using a 30-year period to normalize a 10-year period. Atmos' Mr. Smith stated in his direct testimony that "[t]he manner of computing the weather adjustment is the same as that approved by the Commission in GUD No. 9762."[290] Mr. Smith goes on to state that "[h]eating degree-day (HDD) data for each of the Mid-Tex Division's five source weather stations (Abilene, Dallas, Waco, and Wichita Falls) were updated to compute 10-year "normals" for each month (reference BDS-4 schedules)."[291] In the hearing, Atmos witness Smith testified "we take the ten-year average and then smooth it or stylize it to compote to 30-year normals of NOAA and call that normal."[292]

Examiner' Analysis and Recommendations

As to the economic adjustment made by Atmos to the number of customers, Atmos removed this adjustment. As to the volumetric adjustment for declining sales, Atmos has not proposed such an adjustment in prior cases. It appears to the Examiners that this adjustment is not unlike the customer adjustment. A review of the evidence in the case shows just the opposite, an increase in both the number of customers and volumes sold. The City of Dallas makes the point that the calculation would produce an inaccurate result. The Examiners believe Atmos has not met its burden of proof in justifying a declining usage adjustment. As a result, the Examiners recommend denying the declining volume adjustment.

As to the whether or not Atmos has used a 10-year or 30-year calculation, Atmos argued in GUD No. 9670 that a simple 10-year weather normalization calculation was the proper methodology to calculate normalized volumes[293]. The utility apparently modified the calculation in GUD No. 9762 to using a 30-year calculation to normalize the 10-year average. The Examiners find it troublesome that Atmos fought in GUD No. 9670 to change the 30-year calculation to a 10-year calculation and has since changed its mind to use a hybrid calculation. This change was not litigated in GUD No. 9762, the most recent Mid-Tex rate case. Atmos appears to have made this change in its calculations in GUD No. 9762. The Examiner's recommend a disallowance of January through March 2009 plant additions. As a result, the proper period to use for billing determinants is December 31, 2008 data. Based upon the evidence in the record, the Examiners recommend the Commission adopt the December 31, 2008 billing determinants, which is consistent with the Examiner's recommendation for gross plant.

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[289] City of Dallas Initial Brief page 20
[290] Atmos Witness Gary L. Smith Direct Testimony, page 14.
[291] *Id*
[292] Initial Brief of State of Texas, page 10 referencing transcript Vol. 2 at 72:24-73:1
[293] 9670 PFD, page 147 and GUD No. 9670, FOF 203.

X. TARIFFS AND MISCELLANEOUS

A. Rider GCR

Atmos proposes two changes to the Rider GCR – Gas Cost Recovery Tariff. Among those are to change the interest rate from 4.69% on over and under recoveries to that published by the Public Utility Commission each December. The current rate in effect is 2.09% and allows transaction-related fees, gains or losses and other transaction costs associated with the use of various financial instruments that are executed by the company for the purpose of price volatility mitigation.

1. Interest Rate Change

Atmos did not provide much in the area of testimony and the parties did not address the change of interest rate. The Examiners recommend approving this change.

2. Financial Transaction Costs

The sum total of the details of the request by Atmos relative to financial hedging is provided in the tariff. Each mirrors Mr. Park's Direct Testimony, "Also includes any transaction-related fees, gains or losses and other transaction costs associated with the use of various financial instruments that are executed by the Company for the purpose of price volatility mitigation." Atmos provided no additional details in their testimony as to costs associated with the financial instruments or how much they intend to hedge or what hedging mechanisms they will use in the future.

During cross-examination, Mr. Park provided additional details saying they intend to buy swaps.[294] Upon cross examination by Dallas, Mr. Park was not willing to commit to limits on amounts hedged or costs associated with its proposed hedging program. Again, upon cross examination by RRC Staff, Mr. Park disclosed the utility plans to hedge up to 50 percent of winter baseload.[295]

Mr. Park says Atmos modeled its tariff language after CenterPoint Energy Entex and Texas Gas Service. Upon cross examination by the Examiners on the issue of hedging, Mr. Park was vaguely familiar with CenterPoint's hedging program and knew nothing of Texas Gas Service's program.[296] When asked, Mr. Park was not aware of the reports filed by CenterPoint on their hedging program included in their Gas Procurement Plan filed with the Commission annually. Mr. Park was not aware that CenterPoint reported an additional cost to the consumer of $128 million, assuming it had done no financial hedging.[297] However, Mr. Park does explain that the purpose of financial hedging is not to save the consumer any money. Its purpose is to mitigate the risk of price

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[294] Transcript Volume 1 45:6-8.
[295] Transcript Volume 1 66:18-22.
[296] Transcript Volume 2 20:8-10.
[297] Transcript Volume 2 21:15-18.

spikes.[298]

The City of Dallas introduced the fact that Atmos spent $6 million to update the billing system, $2.1 million being allocated to Mid-Tex. Included in that update was for the implementation of the Weather Normalization Adjustment (WNA) functionality.[299] It is not known how much of the $6 million was attributed to the WNA. Dallas is concerned that the utility will need to update the billing software to implement the hedging program.

Railroad Commission Staff apparently asked for performance reports for hedging in other jurisdictions in a Request For Information (RFI) to which the utility responded there were none.[300] At the hearing, Mr. Park testified that Atmos is hedging in all states but one, Colorado. And, upon cross examination, Mr. Park admitted he is aware that Atmos has a policy document on gas cost hedging but that no one asked for it by name.[301]

The Examiners asked Mr. Park during the hearing if the Purchased Gas Adjustment (PGA) accomplishes mitigation of price volatility because of the way Atmos estimates the gas cost and reconciles it annually.[302] Mr. Park admitted that the PGA is one tool that mitigates price volatility. Physical hedging is another.

Examiners' Analysis and Recommendations

Atmos has requested the use of financial hedging to mitigate price volatility. Atmos has offered few details in its hedging program. The lack of details relative to types of instruments, percentage of volumes hedged and the potential costs to the consumer causes concern to the Examiners and the parties. Atmos is essentially requesting a blank check for financial hedging. Atmos already has a mechanism in place for price volatility mitigation, the PGA. The consumer does not see price spikes. In so far as locking in a price to reduce the risk of price spikes using a financial instrument, Atmos witness Mr. Park acknowledges that physical contracts achieve the same thing with the same risk.[303]

The question with financial hedging becomes: Is the benefit to the customer worth the added costs associated with mitigating price volatility? The customer is absorbing all risk in the effort to mitigate price volatility. As in the case of CenterPoint Entex, Entex states in their Gas Procurement Plan that the additional cost to the consumer was $128 million, as compared to not hedging and purchasing all of the gas at Houston Ship Channel first of the month pricing. Based on the evidence in the record, the Examiners recommend the Commission deny Atmos' plan for financial hedging.

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[298] Transcript Volume 2 23:5-12.
[299] Transcript Volume 1 52:19-23.
[300] Transcript Volume 1 69:11-14.
[301] Transcript Volume 1 70:10-14.
[302] Transcript Volume 2 23:13-25 and 24:1-3.
[303] Transcript Volume 2 21:21-25 and 22:1-3.

B. CEE TARIFF

Atmos proposes several changes to the Conservation & Energy Efficiency (CEE) Tariff. Atmos proposes increasing the qualifying customer benefit from $200 to $1500. Additionally, Atmos proposes to add language to include related gas plumbing and necessary labor, plus to include other government energy efficiency program agencies for billing assistance. Atmos proposes reporting changes that remove the words "with details of" and replacing those words with 'including' just prior to the sentence that concerns amounts paid out during the program year. Atmos in its Initial Brief following the hearing simply stated that other than clarifying questions at the hearing, the proposed changes were not challenged.

The Examiners find several areas regarding the CEE Tariff disturbing. When asked about the performance of the CEE program approved in GUD No. 9762, Atmos witness David J. Park knew very little about what the existing program had done or how many customers it had helped. When asked if a report had been filed concerning the performance of the existing program, the answer was no. Mr. Park replied no report is required until 120 days after the end of the program year, he understood to be in September. However, Atmos did provide a report upon request of the Examiners in the hearing that shows 1,035 customers have been helped and 166 homes have been winterized through the funding of various agencies.[304] The report shows $425,364.83 has been spent through July 2009.

The tariff states it is a voucher system that will provide free energy savings materials to qualified individuals. And, the tariff states a third party administrator will coordinate the qualification of customer, voucher distribution, subsequent verification and reimbursement of eligible expenditures and general program administration. Nothing in the report provided shows who the third party administrator is, administrative costs or if any money has been used for administrative costs. It does show advancing amounts on 25 different occasions to 22 different organizations. The report does not identify how many customers these organizations helped, if any.

In addition, the account, FERC account no. 908, identified in the cost of service model did not show a beginning balance of what should have been the difference between an initial $2,000,000 funding and the $425,364.83 spent. When asked about that, Mr. Park replied "the program didn't start until after June 2008. So the test year was June 2008."[305] No known and measurable adjustment was made in the cost of service work papers for the balance when the errata was filed for known and measurable change through March 2009.

The sponsoring witness, Mr. Park, was not very knowledgeable about the past performance of the existing program. Atmos' response to providing a report was that they hadn't because it was not due in September rather than to provide the information readily. Only upon the request of the Examiners did Atmos file a report. The report that was filed did not provide detailed information,

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304 Atmos Exhibit 21.

305 Transcript Volume 2 34:5-7.

giving a perception that Atmos has not been maintaining the detailed reporting that the existing tariff requests.

Examiner' Analysis and Recommendation

Based upon the above, the Examiners recommend initiation of a full review of the program's effectiveness after the report is filed, 120 days after September 2009, with the Commission. The Examiners recommend the utility's proposed changes with one exception, the Examiners recommend denying the change of wording that removes "with details of".

C. GRIP

There are two issues related to the Gas Reliability Infrastructure Program (GRIP). First, is whether to remove specific projects that were voluntarily removed by Atmos in GUD No. 9802, Application of Atmos Energy Corp., Mid-Tex Division for the Test Year 2007 Annual Interim Rate Adjustment Program for the Environs Areas. Second, is refunds requested by Dallas. The following projects were removed from the 2007 Interim Rate Adjustment (IRA):

Project No.	Description	$ Amount	Category	GUD No. 9802 work paper Ref.
Shared Services				
010.11191	File Cabinets	64.00	Furniture	Project Report
010.11256	Tenant Improvement	85,420.00	Facility Improvement	WP/Sch A
010.11282	Tenant Improvement	189,114.00	Facility Improvement	WP/Sch A
Various	Shared Services	49,884.50	Meals & Entertain	WP/Sch A
Various	Shared Services	59,484,95	Meals & Entertain	WP/Sch A
010.11142	Billing System for WT Division	377,254.00	ITS	RFI 1-43
010.11279	Billing System for WT Division	310,433.00	ITS	RFI 1-46
Sub-Total Shared Services		**$ 1,071,654.45**		
Mid-Tex Division Direct				
080.24311	Segways	66,384.00	Meter Reading Equip	RFI 1-39
080.23672	Office Furniture	50,584.00	Furniture	RFI 1-32

Various	Direct Expenses Capitalized	14,331.17	Meals & Entertain	WP/Sch A
Various	Direct Expenses Capitalized	95,896.89	Meals & Entertain	WP/Sch A
Sub-Total Mid-Tex Direct		**$ 227,196.06**		
Grand Total		**$ 1,298,850.51**		

Atmos has included a portion of the above projects and expenses in this docket for consideration.[306] Atmos has not included in this proceeding the meals and entertainment expenses noted in the above table.[307]

Examiner' Analysis and Recommendation

The Examiners recommend consistency on this issue. Atmos removed these expenses from its GRIP filing because they were controversial in nature. The Commission has excluded projects of this type from the IRA calculations since the first GRIP was reviewed in 2005. The Examiners recommend removal of these projects ($1,079,253, net of meals and entertainment already excluded from this filing) from rate base for consistency. The effect to the revenue requirement is $133,619.

D. GRIP REFUNDS

The City of Dallas has identified two projects that Dallas contends were placed into service prior to being used and useful. The result of placing these two projects in the 2007 GRIP and calculating the IRA has resulted in an overcharge. The two projects are identified as Project Nos. 080.23983 and 080.23337. The City of Dallas states the two were included in the 2007 GRIP as if it had been placed into service in December.[308] During the hearing, Atmos noted the tie-in date was February 2008.[309] Dallas contends used and useful is not the date the project may be completed but when the project is tie-in and could be used. Dallas has requested the Commission find the projects were placed in the GRIP for calculation of an IRA too early and order refunds.

Project No. 080.23983 had a value of $1,972,865 and Project No. 080.23337 had a value of $1,000,038. The significance of placing the projects in GRIP early means the rate calculated was higher than had the projects been left out. Dallas is not saying the projects are not valid projects, just that they were included in the GRIP before gas flowed through the pipe and, therefore, was not used and useful.

Atmos during the hearing stated the terminology agreed to between the Cities and the Commission regarding "tie-in" is the date placed in service is the last month that expenses occurred

[306] Transcript Volume Four 109:6-11.
[307] Transcript Volume Four 109:13-25, 110:1-6.
[308] City of Dallas Initial Brief, page 39.
[309] Transcript Volume 3 194-195.

on that particular project.[310] Atmos in its Reply Brief stated that the inspection of the tie-in welds is necessary under pipeline safety regulations and the inspections were done on December 13 and December 28, 2007.[311] Atmos contends this proves the projects were completed in 2007. Atmos believes the inspection report proves the two projects were tied into the existing system and that gas can begin flowing.[312]

Examiner' Analysis and Recommendation

The question is what constitutes "in service." The City of Dallas contends "in service" should be when the pipe is being used or flowing gas. Atmos, on the other hand, believes "in service" is when the final inspection occurs and the pipe *can begin* flowing gas. The Examiners see the issue as a decision between what is both used and useful. Pipe that has been tied into the system may be useful but not used. The term "in service" if tied into the existing system and has the capability of flowing gas may not flow gas for several months. Tex. Util. Code § 104.053 states "Gas utility rates shall be based on the adjusted value of invested capital used and useful to the utility in providing service..." The Examiners find evidence that gas was not flowing in the pipe in December 2007. However, the pipe was completed to the point where it could flow gas. The Examiners do not find that sufficient evidence was shown that either project was not both used and useful. As a result, the Examiners recommend denying the City of Dallas' request.

XI. CONCLUSION

Atmos Mid-Tex requested a total base revenue requirement of $ 1,729,495,319, which would result in a base revenue increase of $ 42,509,227. For the reasons discussed in the preceding sections of this Proposal for Decision, the Examiners recommend that the Commission approve a total base revenue requirement of $ 1,729,821,184 which will result in a base revenue increase of $ 23,736,945.

Respectfully submitted,

John Chakales
Hearings Examiner
Office of General Counsel

Mark Brock
Technical Examiner
Gas Services Division

Lynne LeMon
Technical Examiner
Gas Services Division

310 Transcript Volume 3 195.
311 Atmos Reply Brief, page 4.
312 *Id*

RAILROAD COMMISSION OF TEXAS

PETITION FOR DE NOVO REVIEW OF THE DENIAL OF THE STATEMENT OF INTENT FILED BY ATMOS ENERGY CORP., MID-TEX DIVISION BY THE CITY OF DALLAS; STATEMENT OF INTENT TO INCREASE GAS UTILITY RATES IN THE UNINCORPORATED AREAS SERVED BY THE MID-TEX DIVISION	§ § § § § § § § §	GAS UTILITIES DOCKET NO. 9869

FIRST REVISED PROPOSED FINAL ORDER

Notice of Open Meeting to consider this Order was duly posted with the Secretary of State within the time period provided by law pursuant to TEX. GOV'T CODE ANN. Chapter 551, et seq. (Vernon 2004 & Supp. 2008). The Railroad Commission of Texas adopts the following findings of fact and conclusions of law and orders as follows:

FINDINGS OF FACT

1. Atmos Energy Corp., Mid-Tex Division ("Atmos") is a utility as that term is defined in the Texas Utility Code and is subject to the jurisdiction of the Railroad Commission of Texas ("Commission").

2. Atmos owns and operates a gas distribution system that provides gas service to customers located within the City of Dallas ("Dallas"). Atmos provides gas distribution services to environs customers located in the following counties: Anderson, Archer, Bandera, Baylor, Bell, Bosque, Brazos, Brown, Burleson, Burnet, Callahan, Cherokee, Childress, Clay, Coke, Coleman, Collin, Comanche, Cooke, Coryell, Dallas, Delta, Denton, Eastland, Ellis, Erath, Falls, Fannin, Fisher, Foard, Freestone, Gillespie, Grayson, Gregg, Hamilton, Hardeman, Haskell, Henderson, Hill, Hood, Hopkins, Houston, Hunt, Jack, Johnson, Jones, Kaufman, Kendall, Kerr, Knox, Lamar, Lampasas, Lee, Leon, Limestone, Llano, Madison, McLennan, Milam, Mills, Mitchell, Montague, Navarro, Nolan, Palo Pinto, Parker, Rains, Red River, Robertson, Rockwall, Runnels, Rusk, San Saba, Scurry, Shackelford, Smith, Somervell, Tarrant, Taylor, Throckmorton, Tom Green, Travis, Van Zandt, Wichita, Wilbarger, Williamson, Wise, Wood, and Young

3. On November 5, 2008, Atmos filed a statement of intent to increase rates within the City of Dallas, Texas. On March 25, 2009, Dallas denied Atmos' rate request and reduced Atmos' rates for providing gas service to customers located within Dallas.

4. On April 23, 2009, Atmos filed with the Commission a petition for *de novo* review of Dallas' denial of Atmos' statement of intent and reduction in rates. Atmos included in its petition for *de novo* review a request that the Commission reinstate Atmos' rates for gas service that the utility was charging prior to Dallas' March 25, 2009, ordinance reducing the utility's rates.

5. On April 23, 2009, Atmos filed with the Commission a statement of intent to change rates in the

unincorporated areas served by Atmos. Atmos has proposed that the rates become effective on May 28, 2009.

6. On May 19, 2009, the Commission suspended the implementation of Atmos' proposed rates for up to 150 days.

7. In support of its request to reinstate rates Atmos submitted a supersedes bond, in the amount of $2,099,687, to protect the rate-payers pending the issuance of a final and appealable Commission decision establishing just and reasonable gas utility rates for the gas service Atmos provides within the City of Dallas. The commission approved Atmos' supersedes bond on June 18, 2009.

8. On May 1, 2009, the City of Dallas ("Dallas") intervened in this proceeding. On April 27, 2009, the Staff of the Railroad Commission of Texas ("Staff") intervened in this proceeding. On May 11, 2009, the State of Texas ("State"), by and through the Office of the Attorney General of Texas, Consumer Protection and Public Health Division, Public Agency Representation Section, intervened in this proceeding. No other persons intervened, filed protests or otherwise participated in this docket.

9. On May 8, 2009, Atmos filed a Motion to Adopt Joint Proposed Procedural Schedule which extended the statutory deadline in this proceeding until November 24, 2009, and was granted by the Hearings Examiners assigned to this docket on May 12, 2009.

10. Atmos' proposed rate increase will affect approximately 43,414 residential, 2,016 commercial, and 74 industrial sales and transportation customers.

Test Year

11. The test year in this case was the 12-month period ending June 30, 2008.

Books and Records

12. Atmos maintains its books and records in accordance with the requirements of the Federal Energy Regulatory Commission's (FERC) Uniform System of Accounts.

Notice and Hearing

13. For its customers located in the City of Dallas, Atmos Mid-Tex published notice once each week for four consecutive weeks in newspapers of general circulation in each county in which Atmos provides gas service. Notice was published once a week for four consecutive weeks beginning November 11, 2008 and ending the week of December 1, 2008. For customers located in the environs, Atmos provided notice by means of a bill insert beginning on May 22, 2009 and ending on June 19, 2009.

14. On August 4, 2009, the Examiners mailed by United States mail, postage prepaid, a Notice of Hearing to all affected parties giving notice of the final hearing to be conducted in Austin, Texas, at the offices of the Railroad Commission of Texas on August 18, 2009.

15. On August 4, 2009, the Examiners mailed by United States mail, postage prepaid, a Notice of Hearing to all county judges of the counties in which affected customers reside, giving notice of the final hearing to be conducted in Austin, Texas, at the offices of the Railroad Commission of Texas on August 18, 2009.

16. The Hearing convened on August 18, 2009 and was concluded on August 21, 2009.

Rate Base

17. The total amount of costs identified and attributable to Poly 1 pipe replacement is $59,838 and has been removed from Atmos' rate base.

18. Atmos proposed adjustments to gross plant, accumulated depreciation, and ADIT balances for the time period January 1, 2009, through March 31, 2009, in an errata filing submitted by Atmos on August 4, 2009. Atmos added more than 1,200 new projects in the August 4, 2009, errata filing which totaled approximately $33 million in capital investment to be added to Atmos' rate base. Atmos' proposal to add 1,200 new capital projects to rate base in its August 4, 2009, errata filing is unreasonable because the Commission, Examiners and intervenors in this proceeding do not have adequate time to review the data. It is unreasonable for Atmos to make post-test year adjustments to gross plant, accumulated depreciation and ADIT for the time period January 1, 2009 through March 31, 2009.

19. It is reasonable for the Commission to remove the January through March 2009 plant additions of $32,792,028 for Mid-Tex and $268,610 for SSU for a total removal of $33,060,638 from Atmos' rate base.

20. It is reasonable for Atmos to update its test year data through December 31, 2008, for known and measurable changes.

21. The net plant amounts shown in the attached schedules are reasonable for the plant that is used and useful in providing gas utility service.

22. Atmos initially requested a Cash Working Capital adjustment to rate base of ($31,935,075). Atmos updated this request to ($33,017,661).

23. Atmos Mid-Tex prepared a lead-lag study to determine an amount of cash working capital.

24. The evidence establishes that Atmos' proposed collection lag period of 17.95 days is reasonable and accurate.

25. The billing lag is the one-day lag between receiving payment and having funds available to draw at the bank. It is reasonable for Atmos to use a one-day billing lag.

26. The evidence establishes that a 42.02 day gas cost expense lag is reasonable and accurate.

27. The evidence establishes that a 24.64 day total labor expense lag is reasonable and accurate.

28. The evidence establishes that a 29.41 day non-labor O&M lag is reasonable and accurate.

29. The evidence establishes that a 95 day lag on franchise fees paid is reasonable and accurate.

30. The evidence indicates that Atmos made an appropriate adjustment to prepayments related to local gross receipts taxes of $4,875,708 and no further adjustment is necessary.

31. A negative cash working capital of ($33,017,661) as set out in the attached schedules is just and reasonable.

32. It is reasonable to remove from rate base remodeling costs of $71,293that were allocated to Mid-Tex from Shared Service Unit as part of Project Nos. 010.11352 and 010.11353.

33. Accumulated Deferred Income Taxes ("ADIT") arise because Internal Revenue Code timing requirements related to the recognition of tax assets and liabilities differ from the timing requirements established by U.S. Generally Accepted Accounting Procedures (GAAP). Atmos' proposed treatment of ADIT is reasonable.

Expenses

34. Atmos' proposal to include $5,744,689 in incentive compensation in this request, consisting of $3,544,716 in SSU expenses and $2,229,973 of direct incentive expenses, is reasonable because Atmos' aggregate level of compensation is not outside the normal range of compensation.

35. Atmos' proposed adjustment to annualize employee base salaries and to include a 3.5 percent annual merit increase which occurred and was effective October 1, 2008 is reasonable

36. Atmos' proposed overtime expense level is reasonable because there is no evidence that establishes Atmos incurred unnecessary overtime expenses or mismanaged its employees so that excessive overtime was taken during the test year.

37. Atmos' proposed employee benefits expense is based on the projected per employee cost from an actuarial study performed by Towers Perrin and is reasonable and necessary.

38. Atmos' proposal to average the uncollectible expense for three years 2006, 2007 and 2008 is reasonable and necessary.

39. Atmos' proposed outside services expense is reasonable and necessary.

40. Atmos' proposed distribution load dispatching expense during the test year was reasonable and necessary.

41. Atmos' proposed test year level of gasoline expense is reasonable and necessary.

42. Atmos' proposed test year level of pipeline integrity testing expense is reasonable and necessary.

43. Atmos' proposed test year level of pipeline employee expense is reasonable and necessary.

44. Atmos' proposed test year level of relocation expense is reasonable and necessary.

45. Atmos' proposed test year level of office supply expense is reasonable and necessary.

Rate of Return and Cost of Capital

46. It is reasonable for Atmos to use a quarterly Discounted Cash Flow ("DCF") model as one method to determine a reasonable cost of equity because Atmos' and the companies in the proxy group make dividend payments on a quarterly basis and the quarterly DCF model accurately reflects the cash flows an investor receives.

47. It is not reasonable to include four companies, Energen, EQT, ONEOK, and Questar, in a proxy group for purposes of determining Atmos' cost of equity because these four companies generate a higher percentage of revenues earned from non-gas distribution activities than does Atmos and the other proxy group companies.

48. The inclusion of an estimation of flotation costs is not necessary, reasonable and required to determine Atmos' cost of equity because there is no evidence that flotation costs affect the opinions of investors.

49. It is not reasonable for Atmos to use a growth rate utilizing analyst estimates of future EPS growth for the individual companies used in the proxy study because there is no evidence that estimates of future EPS growth rates for the individual companies in the proxy group are reliable, accurate, and capable of forecasting the future EPS growth of these specific companies with accuracy and reliability.

50. It is not reasonable for Atmos to use the forecasted yield on the twenty-year Treasury bond in a CAPM study because there is no evidence that the forecasted yield is reasonable, reliable or accurate.

51. It is reasonable to use Atmos' actual capital structure of 48.91 percent common equity and 51.09 percent long-term debt for purposes of determining Atmos' weighted average cost of capital and allowable rate of return.

52. It is reasonable to use Atmos' actual cost of long-term debt of 6.88 percent for purposes of determining Atmos' weighted average cost of capital and allowable rate of return.

53. It is reasonable to use a cost of equity of 10.00 percent for purposes of determining Atmos' weighted average cost of capital and allowable rate of return.

54. An overall rate of return of 8.41 percent based on Atmos' weighted average cost of capital is reasonable.

Shared Services

55. Atmos' proposed allocation of both the Waco and Amarillo call centers and Cost Center 1158 using Rate 2 is reasonable.

56. Atmos did not make additions to accounts 399.01, 399.02, and 399.24 in 21 months sufficient to increase the balances in these accounts to a point where they would not be fully depreciated. It is reasonable to remove the depreciation expense of these three accounts be removed from the cost of service.

57. Atmos' proposed treatment of Cost Center 1502 - Corporate Secretary, Cost Center 1162 - Benefits Accounting, Cost Center 1226 - Customer Service, Cost Center 1228 - Customer Revenue Management, and Cost Center 1408 - Employee Development is reasonable.

58. Atmos' proposal to allocate costs for Shared Service Unit Cost Centers 1109, 1115, 1148, 1200, 1215, 1226, 1227, and 1228 based on allocation factor Rate 2 or 49.18% is reasonable.

Rate Design

59. Atmos' proposed minimum customer charges for all rate classes, as shown in the attached schedules is reasonable because it will allow for a higher recovery of fixed costs and result in a rate structure that is more de-coupled from volume usage than Atmos' previous rates.

60. Atmos' proposed declining usage adjustment is not reasonable.

62. Atmos' proposed weather normalization calculation is reasonable.

CONCLUSIONS OF LAW

1. Atmos Energy Corp., Mid-Tex Division ("Atmos") is a "Gas Utility" as defined in TEX. UTIL. CODE ANN. §101.003(7) (Vernon 2007 & Supp. 2008) and §121.001 (Vernon 2007 & Supp. 2008) and is therefore subject to the jurisdiction of the Railroad Commission ("Commission") of Texas.

2. Under TEX. UTIL. CODE ANN. §102.001(b) (Vernon 2007 & Supp. 2008) the Commission has exclusive appellate jurisdiction to review an order or ordinance of a municipality exercising exclusive original jurisdiction over a gas utility.

3. The Commission has jurisdiction over Atmos and Atmos' petition for *de novo* review under TEX. UTIL. CODE ANN. §§ 102.001, 103.051, 103.054, 103.055, 104.001 and 104.201 (Vernon 2007 & Supp. 2008).

4. This Statement of Intent and Petition for Review was processed in accordance with the requirements of the Gas Utility Regulatory Act (GURA), and the Administrative Procedure Act, TEX. GOV'T CODE ANN. §§2001.001-2001.902 (Vernon 2000 and Supp. 2004) (APA).

5. Under TEX. UTIL. CODE ANN. §102.001 (Vernon 2007 & Supp. 2008), the Commission has exclusive original jurisdiction over the rates and services of a gas utility that distributes natural gas in areas outside of a municipality and over the rates and services of a gas utility that transmits, transports, delivers, or sells natural gas to a gas utility that distributes the gas to the public.

6. In accordance with the stated purpose of the Texas Utilities Code, Subtitle A, expressed under TEX. UTIL. CODE ANN. §101.002 (Vernon 2007 & Supp. 2008), the Commission has assured that the rates, operations, and services established in this docket are just and reasonable to customers and to the utilities.

7 TEX. UTIL. CODE ANN. §104.107 (Vernon 2007 & Supp. 2008) provides the Commission's authority to suspend the operation of the schedule of proposed rates for 150 days from the date the schedule would otherwise go into effect.

8. The proposed rates constitute a major change as defined by TEX. UTIL. CODE ANN. §104.101 (Vernon 2007 & Supp. 2008).

9. In accordance with TEX. UTIL. CODE §104.103 (Vernon 2007 & Supp. 2008), 16 TEX. ADMIN. CODE ANN. §7.230 (2002), and 16 TEX. ADMIN. CODE ANN. §7.235 (2002), adequate notice was properly provided.

10. Atmos did not meet the required burden of proof in accordance with the provisions of TEX. UTIL. CODE ANN. §104.008 (Vernon 2007 & Supp. 2008) on the elements of its requested rate increase identified in this order, and as set forth in the schedules and tariffs attached hereto.

11. The rates and tariffs proposed by the Examiners, as set forth in the above findings of fact and attached hereto, are found to be just and reasonable, not unreasonably preferential, prejudicial, or discriminatory, and are sufficient, equitable, and consistent in application to each class of consumer, as required by TEX. UTIL. CODE ANN. §104.003 (Vernon 2007 & Supp. 2008).

12. The overall revenues as established by the findings of fact and attached schedules and tariffs are reasonable; fix an overall level of revenues for Atmos that will permit the company a reasonable opportunity to earn a reasonable return on its invested capital used and useful in providing service to the public over and above its reasonable and necessary operating expenses, as required by TEX. UTIL. CODE ANN. § 104.051 (Vernon 2007 & Supp. 2008); and otherwise comply with Chapter 104 of the Texas Utilities Code.

13. The rates and tariffs set forth in the findings of fact and attached schedules will not yield to Atmos more than a fair return on the adjusted value of the invested capital used and useful in rendering service to the public, as required by TEX. UTIL. CODE ANN. § 104.052 (Vernon 2007 & Supp. 2008).

14. It is reasonable for the Commission to allow Atmos to include a Cost of Gas Clause in its rates to provide for the recovery of all of its gas costs, in accordance with 16 TEX. ADMIN. CODE § 7.5519 (2002).

15. All expenses for lost and unaccounted for gas in excess of 5.0 percent shall be disallowed, consistent with TEX. ADMIN. CODE § 7.5519 (2002).

16. Atmos is required by 16 TEX. ADMIN. CODE §7.315 (2002) to file electronic tariffs incorporating rates consistent with this Order within thirty days of the date of this Order.

17. Rate case expenses for GUD No. 9869 will be considered by the Commission in accordance with TEX. UTIL. CODE ANN. §104.008 (Vernon 2007 & Supp. 2008), and 16 TEX. ADMIN. CODE §7.5530 (2002), in a separate proceeding.

18. Atmos' mailing of notice meets the statutory and rule requirements of notice and provides sufficient information to rate payers about the statement of intent and satisfies the requirements imposed under TEX. UTIL. CODE ANN. §104.103(b)(2) (Vernon 2007 & Supp. 2008) and 16 TEX. ADMIN. CODE ANN. §7.230 (2002), and 16 TEX. ADMIN. CODE ANN.§7.235 (2002).

IT THEREFORE ORDERED that the rates, rate design, and service charges established in the findings of fact and conclusions of law and in the attached schedules for Atmos Mid-Tex are hereby **APPROVED.**

IT IS FURTHER ORDERED that, in accordance with 16 TEX. ADMIN. CODE §7.315, within 30 days of the date this Order is signed, Atmos Mid-Tex shall file tariffs with the Gas Services Division. The tariffs shall incorporate rates, rate design, and service charges consistent with this Order, as stated in the findings of fact and conclusions of law and shown in the attached Schedules.

IT IS FURTHER ORDERED that Atmos Mid-Tex shall not charge any rate that has not been successfully filed and accepted as a tariff filing electronically pursuant to TEX. UTIL. CODE §§ 102.151 and 104.002 and 16 TEX. ADMIN. CODE ANN. § 7.315 (2008).

IT IS FURTHER ORDERED that this Order shall not be final and effective until twenty days after a party is notified of the Commission's Order. Under TEX. GOV'T CODE § 2001.142(c), a party shall be presumed to have been notified of the Commission's Order three days after the date on which the notice is actually mailed. If a timely motion for rehearing is filed by any party at interest, this Order shall not become final and effective until such motion is overruled or, if granted, this Order shall be subject to further action by the Commission pursuant to TEX. GOV'T CODE §2001.146(e), the time allotted for Commission action on a motion for rehearing in this case prior to its being overruled by operation of law, is hereby extended until 90 days from the date the order is served on the parties.

IT IS FURTHER ORDERED that all proposed findings of fact and conclusions of law not specifically adopted in this Order are hereby **DENIED**. **IT IS ALSO ORDERED** that all pending motions and requests for relief not previously granted or granted herein are hereby **DENIED**.

All requested findings of fact and conclusions of law which are not expressly adopted herein are denied.

All pending motions and requests for relief not previously granted or granted herein are denied.

SIGNED this _____ day of _____, 2009.

RAILROAD COMMISSION OF TEXAS

____
CHAIRMAN VICTOR G. CARRILLO

____
COMMISSIONER ELIZABETH A. JONES

____
COMMISSIONER MICHAEL L. WILLIAMS

ATTEST:

____
SECRETARY

Exhibit A

Tariffs

RATE SCHEDULE:	R – RESIDENTIAL SALES	
APPLICABLE TO:	The City of Dallas & Environs	
EFFECTIVE DATE:		PAGE:

Application
Applicable to Residential Customers for all natural gas provided at one Point of Delivery and measured through one meter.

Type of Service
Where service of the type desired by Customer is not already available at the Point of Delivery, additional charges and special contract arrangements between Company and Customer may be required prior to service being furnished.

Monthly Rate
Customer's monthly bill will be calculated by adding the following Customer and Mcf charges to the amounts due under the riders listed below:

Charge	Amount
Customer Charge per Bill	$16.00 per month
Commodity Charge – All Mcf	$ 0.4932 per Mcf

Gas Cost Recovery: Plus an amount for gas costs and upstream transportation costs calculated in accordance with Part (a) and Part (b), respectively, of Rider GCR.

Weather Normalization Adjustment: Plus or Minus an amount for weather normalization calculated in accordance with Rider WNA.

Franchise Fee Adjustment: Plus an amount for franchise fees calculated in accordance with Rider FF. Franchise Fees are to be assessed solely to customers within municipal limits. This does not apply to Environs Customers.

Tax Adjustment: Plus an amount for tax calculated in accordance with Rider TAX.

Surcharges: Plus an amount for surcharges calculated in accordance with the applicable rider(s).

Agreement
An Agreement for Gas Service may be required.

Notice
Service hereunder and the rates for services provided are subject to the orders of regulatory bodies having jurisdiction and to the Company's Tariff for Gas Service.

RATE SCHEDULE:	C – COMMERCIAL SALES		
APPLICABLE TO:	The City of Dallas & Environs		
EFFECTIVE DATE:		PAGE:	

Application
Applicable to Commercial Customers for all natural gas provided at one Point of Delivery and measured through one meter and to Industrial Customers with an average annual usage of less than 3,000 Mcf.

Type of Service
Where service of the type desired by Customer is not already available at the Point of Delivery, additional charges and special contract arrangements between Company and Customer may be required prior to service being furnished.

Monthly Rate
Customer's monthly bill will be calculated by adding the following Customer and Mcf charges to the amounts due under the riders listed below:

Charge	Amount
Customer Charge per Bill	$ 30.00 per month
Commodity Charge - All Mcf	$ 0.6167 per Mcf

Gas Cost Recovery: Plus an amount for gas costs and upstream transportation costs calculated in accordance with Part (a) and Part (b), respectively, of Rider GCR.

Weather Normalization Adjustment: Plus or Minus an amount for weather normalization calculated in accordance with Rider WNA.

Franchise Fee Adjustment: Plus an amount for franchise fees calculated in accordance with Rider FF. Franchise Fees are to be assessed solely to customers within municipal limits. This does not apply to Environs Customers.

Tax Adjustment: Plus an amount for tax calculated in accordance with Rider TAX.

Surcharges: Plus an amount for surcharges calculated in accordance with the applicable rider(s).

Agreement
An Agreement for Gas Service may be required.

Notice
Service hereunder and the rates for services provided are subject to the orders of regulatory bodies having jurisdiction and to the Company's Tariff for Gas Service.

RATE SCHEDULE:	**I – INDUSTRIAL SALES**	
APPLICABLE TO:	**The City of Dallas & Environs**	
EFFECTIVE DATE:		**PAGE:**

Application
Applicable to Industrial Customers with a maximum daily usage (MDU) of less than 3,500 MMBtu per day for all natural gas provided at one Point of Delivery and measured through one meter. Service for Industrial Customers with an MDU equal to or greater than 3,500 MMBtu per day will be provided at Company's sole option and will require special contract arrangements between Company and Customer.

Type of Service
Where service of the type desired by Customer is not already available at the Point of Delivery, additional charges and special contract arrangements between Company and Customer may be required prior to service being furnished.

Monthly Rate
Customer's monthly bill will be calculated by adding the following Customer and MMBtu charges to the amounts due under the riders listed below:

Charge	Amount
Customer Charge per Meter	$ 550.00 per month
First 0 MMBtu to 1,500 MMBtu	$ 0.1749 per MMBtu
Next 3,500 MMBtu	$ 0.1272 per MMBtu
All MMBtu over 5,000 MMBtu	$ 0.0203 per MMBtu

Gas Cost Recovery: Plus an amount for gas costs and upstream transportation costs calculated in accordance with Part (a) and Part (b), respectively, of Rider GCR.

Franchise Fee Adjustment: Plus an amount for franchise fees calculated in accordance with Rider FF. Franchise Fees are to be assessed solely to customers within municipal limits. This does not apply to Environs Customers.

Tax Adjustment: Plus an amount for tax calculated in accordance with Rider TAX.

Surcharges: Plus an amount for surcharges calculated in accordance with the applicable rider(s).

Curtailment Overpull Fee
Upon notification by Company of an event of curtailment or interruption of Customer's deliveries, Customer will, for each MMBtu delivered in excess of the stated level of curtailment or interruption, pay Company 200% of the midpoint price for the Katy point listed in *Platts Gas Daily* published for the applicable Gas Day in the table entitled "Daily Price Survey."

Replacement Index
In the event the "midpoint" or "common" price for the Katy point listed in *Platts Gas Daily* in the table entitled "Daily Price Survey" is no longer published, Company will calculate the applicable imbalance fees utilizing a daily price index recognized as authoritative by the natural gas industry and most closely approximating the applicable index.

RATE SCHEDULE:	I – INDUSTRIAL SALES	
APPLICABLE TO:	The City of Dallas & Environs	
EFFECTIVE DATE:		PAGE:

Agreement
An Agreement for Gas Service may be required.

Notice
Service hereunder and the rates for services provided are subject to the orders of regulatory bodies having jurisdiction and to the Company's Tariff for Gas Service.

Special Conditions
In order to receive service under Rate I, Customer must have the type of meter required by Company. Customer must pay Company all costs associated with the acquisition and installation of the meter.

RATE SCHEDULE:	T – TRANSPORTATION	
APPLICABLE TO:	The City of Dallas & Environs	
EFFECTIVE DATE:		PAGE:

Application
Applicable, in the event that Company has entered into a Transportation Agreement, to a customer directly connected to the Atmos Energy Corp., Mid-Tex Division Distribution System (Customer) for the transportation of all natural gas supplied by Customer or Customer's agent at one Point of Delivery for use in Customer's facility.

Type of Service
Where service of the type desired by Customer is not already available at the Point of Delivery, additional charges and special contract arrangements between Company and Customer may be required prior to service being furnished.

Monthly Rate
Customer's bill will be calculated by adding the following Customer and MMBtu charges to the amounts and quantities due under the riders listed below:

Charge	Amount
Customer Charge per Meter	$ 550.00 per month
First 0 MMBtu to 1,500 MMBtu	$ 0.1749 per MMBtu
Next 3,500 MMBtu	$ 0.1272 per MMBtu
All MMBtu over 5,000 MMBtu	$ 0.0203 per MMBtu

Upstream Transportation Cost Recovery: Plus an amount for upstream transportation costs in accordance with Part (b) of Rider GCR.

Retention Adjustment: Plus a quantity of gas as calculated in accordance with Rider RA.

Franchise Fee Adjustment: Plus an amount for franchise fees calculated in accordance with Rider FF. Franchise Fees are to be assessed solely to customers within municipal limits. This does not apply to Environs Customers.

Tax Adjustment: Plus an amount for tax calculated in accordance with Rider TAX.

Surcharges: Plus an amount for surcharges calculated in accordance with the applicable rider(s).

Imbalance Fees
All fees charged to Customer under this Rate Schedule will be charged based on the quantities determined under the applicable Transportation Agreement and quantities will not be aggregated for any Customer with multiple Transportation Agreements for the purposes of such fees.

Monthly Imbalance Fees
Customer shall pay Company the greater of (i) $0.10 per MMBtu, or (ii) 150% of the difference per MMBtu between the highest and lowest "midpoint" price for the Katy point listed in *Platts Gas Daily* in the table entitled "Daily Price Survey" during such month, for the MMBtu of Customer's monthly Cumulative Imbalance, as defined in the applicable Transportation Agreement, at the end of each month that exceeds 10% of Customer's receipt quantities for the month.

RATE SCHEDULE:	T – TRANSPORTATION	
APPLICABLE TO:	The City of Dallas & Environs	
EFFECTIVE DATE:		PAGE:

Curtailment Overpull Fee
Upon notification by Company of an event of curtailment or interruption of Customer's deliveries, Customer will, for each MMBtu delivered in excess of the stated level of curtailment or interruption, pay Company 200% of the midpoint price for the Katy point listed in *Platts Gas Daily* published for the applicable Gas Day in the table entitled "Daily Price Survey."

Replacement Index
In the event the "midpoint" or "common" price for the Katy point listed in *Platts Gas Daily* in the table entitled "Daily Price Survey" is no longer published, Company will calculate the applicable imbalance fees utilizing a daily price index recognized as authoritative by the natural gas industry and most closely approximating the applicable index.

Agreement
A transportation agreement is required.

Notice
Service hereunder and the rates for services provided are subject to the orders of regulatory bodies having jurisdiction and to the Company's Tariff for Gas Service.

Special Conditions
In order to receive service under Rate T, customer must have the type of meter required by Company. Customer must pay Company all costs associated with the acquisition and installation of the meter.

RIDER:	GCR – GAS COST RECOVERY	
APPLICABLE TO:	The City of Dallas & Environs	
EFFECTIVE DATE:		PAGE:

Applicable to Rate R, Rate C, and Rate I for all gas sales made by Company, and applicable to Rate R, Rate C, Rate I, and Rate T for recovery of Pipeline System costs. The total gas cost recovery amount due is determined by adding the gas cost calculated in Section (a) below and the pipeline cost calculated in Section (b) below.

The amount due for gas cost (Section (a)) is determined by multiplying the Gas Cost Recovery Factor (GCRF) by the Customer's monthly volume. For Customers receiving service under Rate R and Rate C, monthly volume will be calculated on a Mcf basis. For Customers receiving service under Rate I, monthly volume will be calculated on an MMBtu basis and the quantities will be adjusted as necessary to recover actual gas costs.

The amount due for pipeline cost (Section (b)) is determined by multiplying the Pipeline Cost Factor (PCF) by the Customer's monthly volume. For Customers receiving service under Rate R and Rate C, monthly volume will be calculated on an Mcf basis. For Customers receiving service under Rate I and Rate T, monthly volume will be calculated on an MMBtu basis and the quantities will be adjusted as necessary to recover actual gas costs.

(a) Gas Cost

Method of Calculation

The monthly gas cost adjustment is calculated by the application of a Gas Cost Recovery Factor (GCRF), as determined with the following formula:

GCRF = Estimated Gas Cost Factor (EGCF) + Reconciliation Factor (RF) + Taxes (TXS)

EGCF = Estimated cost of gas, including lost and unaccounted for gas attributed to residential, commercial, and industrial sales, and any reconciliation balance of unrecovered gas costs, divided by the estimated total residential, commercial, and industrial sales. Lost and unaccounted for gas is limited to 5%.

RF = Calculated by dividing the difference between the Actual Gas Cost Incurred, inclusive of interest over the preceding twelve-month period ended June 30 and the Actual Gas Cost Billed over that same twelve-month period by the estimated total residential, commercial, and industrial sales for the succeeding October through June billing months. The interest rate to be used is the annual interest rate on overcharges and under charges by a utility as published by the Public Utility Commission each December. The interest rate for calendar year 2009 is 2.09%.

Actual Gas Cost Incurred = The sum of the costs booked in Atmos Energy Corp., Mid-Tex Division account numbers 800 through 813 and 858 of the FERC Uniform System of Accounts, including the net impact of injecting and withdrawing gas from storage. Also includes a credit or debit for any out-of-period adjustments or unusual or nonrecurring costs typically considered gas costs and a credit for amounts received as Imbalance Fees or Curtailment Overpull Fees.

Actual Gas Cost Billed = EGCF multiplied by the monthly volumes billed to Residential, Commercial and Industrial Sales customers, less the total amount of gas cost determined to have been uncollectible and written off which remain unpaid for each month of the reconciliation period.

Any amount remaining in the reconciliation balance after the conclusion of the period of amortization will be maintained in the reconciliation balance and included in the collection of the next RF.

RIDER:	GCR – GAS COST RECOVERY	
APPLICABLE TO:	The City of Dallas & Environs	
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Atmos Energy shall file annual reports with the Commission, providing by month the following amounts: Gas Cost Written Off, Margin Written Off, Tax and Other Written Off, Total Written Off, Gas Cost Collected and Margin Collected.

TXS = Any statutorily imposed assessments or taxes applicable to the purchase of gas divided by the estimated total residential, commercial, and industrial sales.

ADJ = Any surcharge or refund ordered by a regulatory authority, inclusive of interest, divided by the estimated total residential, commercial, and industrial sales is to be included as a separate line item surcharge.

(b) Pipeline Cost

Method of Calculation

Each month, a Pipeline Cost Factor (PCF) is calculated separately for each Pipeline Cost Rate Class listed below. The formula for the PCF is:

PCF = PP / S, where:

PP = (P - A) x D, where:

P = Estimated monthly cost of pipeline service calculated pursuant to Rate CGS

D = Pipeline service allocation factor for the rate class as approved in the Company's most recent rate case, as follows:

Pipeline Cost Rate Class	Allocation Factor (D)
Rate **R** - Residential Service	.634698
Rate C - Commercial Service	.302824
Rate I - Industrial Service and Rate **T** - Transportation Service	.062478

A = Adjustment applied in the current month to correct for the difference between the actual and estimated pipeline cost revenue of the second preceding month, calculated by the formula:

A = R - (C - A2), where:

R = Actual revenue received from the application of the PP component in the second preceding month.

C = Actual pipeline costs for the second preceding month.

A2 = The adjustment (A) applied to the PP component in the second preceding month.

S = Estimated Mcf or MMBtu for the rate class for the current billing month.

The PCF is calculated to the nearest 0.0001 cent.

The Pipeline Cost to be billed is determined by multiplying the Mcf or MMBtu used by the appropriate PCF. The Pipeline Cost is determined to the nearest whole cent.

RIDER:	WNA – WEATHER NORMALIZATION ADJUSTMENT	
APPLICABLE TO:	The City of Dallas & Environs	
EFFECTIVE DATE:		PAGE:

Provisions for Adjustment

The base rate per Mcf (100,000,000 Btu) for gas service set forth in any Rate Schedules utilized by the cities of the Mid-Tex Division service area for determining normalized winter period revenues shall be adjusted by an amount hereinafter described, which amount is referred to as the "Weather Normalization Adjustment." The Weather Normalization Adjustment shall apply to all temperature sensitive residential, and commercial bills based on meters read during the revenue months of November through April. The five regional weather stations are Abilene, Austin, Dallas, Waco, and Wichita Falls

Computation of Weather Normalization Adjustment

The Weather Normalization Adjustment Factor shall be computed to the nearest one-hundredth cent per Mcf by the following formula:

$$WNAF_i = R_i \quad \frac{(HSF_i \quad (NDD\text{-}ADD) \quad)}{(BL_i \quad + \quad (HSF_i \quad x \quad ADD)\ )}$$

Where

i = any particular Rate Schedule or billing classification within any such particular Rate Schedule that contains more than one billing classification

$WNAF_i$ = Weather Normalization Adjustment Factor for the i^{th} rate schedule or classification expressed in cents per Mcf

R_i = base rate of temperature sensitive sales for the i^{th} schedule or classification utilized by the Commission in the Relevant Rate Order.

HSF_i = heat sensitive factor for the i^{th} schedule or classification divided by the average bill count in that class

NDD = billing cycle normal heating degree days

ADD = billing cycle actual heating degree days

Bl_i = base load sales for the i^{th} schedule or classification divided by the average bill count in that class

The Weather Normalization Adjustment for the j^{th} customer in i^{th} rate schedule is computed as:

WNA_i = $WNAF_i$ x q_{ij}

Where q_{ij} is the relevant sales quantity for the j^{th} customer in i^{th} rate schedule.

ATMOS ENERGY CORPORATION
MID-TEX DIVISION

REVISION NO: 0

RIDER:	**WNA – WEATHER NORMALIZATION ADJUSTMENT**
APPLICABLE TO:	**The City of Dallas & Environs**
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Base Use/Heat Use Factors

	Residential		Commercial	
Weather Station	Base use Mcf	Heat use Mcf/HDD	Base use Mcf	Heat use Mcf/HDD
Abilene	1.03	.0131	9.94	.0562
Austin	1.28	.0164	20.10	.0829
Dallas	1.61	.0199	20.20	.0940
Waco	1.10	.0142	11.57	.0601
Wichita Falls	1.22	.0140	12.04	.0567

Filings with Regulatory Agencies

The Company will file monthly with the regulatory authority a (a) copy of each computation of the Weather Normalization Adjustment Factor, (b) a schedule showing the effective date of each such Weather Normalization Adjustment, and (c) a schedule showing the factors of values used in calculating such Weather Normalization Adjustment.

ATMOS ENERGY CORPORATION
MID-TEX DIVISION

REVISION NO: 0

RIDER:	**CEE – CONSERVATION & ENERGY EFFICIENCY**	
APPLICABLE TO:	**The City of Dallas & Environs**	
EFFECTIVE DATE:		**PAGE:**

Purpose

Atmos Energy Mid-Tex is proposing to institute a complete Conservation & Energy Efficiency program which will offer assistance to qualified customer segments in reducing energy consumption and lowering energy utility bills. The proposal is one where Atmos Energy shareholders will fund a percentage of the allowable expenses incurred annually, with a customer rate component providing the remainder of the funding. Following is a high-level, concept summary of the proposal. Atmos Energy Mid-Tex Division proposes to work with the communities it serves to develop the details of a new tariff and programs addressing conservation and energy efficiency.

Synopsis:

Voucher system to provide free energy savings materials and supplies to qualifying customers of Atmos Mid-Tex. Qualified Customers will receive up to one thousand five hundred dollars ($1,500.00) worth of caulking, weather-stripping, sheathing, sealing, water heater blankets, related gas plumbing and like materials, other energy saving devices such as clock-thermostats, set-back devices ("covered items") from approved suppliers / retailers including necessary labor.
Company will undertake efforts to enlist support from community groups, including its own Employee Action Program, to assist customers with installation. If it is determined that professional installation capabilities are necessary, the parties will agree on labor assistance amounts.

Eligibility

Low Income – Low-income rate-payers that qualify for heating bill assistance through LIHEAP and other government energy efficiency program agencies and all agencies that distribute Atmos "Share the Warmth" funds. Agencies that allocate assistance funds denote customer as Low Income, a status that lasts for one year.
Senior Citizen – Primary account holder can request eligibility through ATM call center or web-site. Customer provides primary SSN which is verified through Social Security Administration. And account holder that is or turns 65 years old in that year becomes eligible.

Funding

Initial program funding will be at two million dollars ($2,000,000). Atmos Energy shareholders will contribute one million dollars ($1,000,000.00) to this initiative annually with ratepayers providing one million dollars ($1,000,000.00) per year. It is proposed that the program operate on an October 1 through September 30 year, with benefits being capped at the two million dollar level for the initial program period.

Administration:

A third-party administrator will coordinate qualification of customers, voucher distribution, subsequent verification and reimbursement of eligible expenditures and general program administration. Program administration expenses will be funded from the annual approved budget.

Audits will be provided all interested parties within 120 days of the end of each program year to determine effectiveness.

RIDER:	CEE – CONSERVATION & ENERGY EFFICIENCY	
APPLICABLE TO:	The City of Dallas & Environs	
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Report

Atmos shall file an annual report detailing cost to administer the program, including the amounts paid out of the program for energy conversation assistance. The report shall also detail the number of applicants, including the numbers rejected and accepted and reason if rejected. The report shall be filed with the Director of the Gas Services Division of the Railroad Commission within 120 days of the end of each program year.

Exhibit B

GUD No. 9869 Schedules