2008.04.03 15:05:57

BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

STATE CORPORATION COMMISSION

APR 03 2008

Docket Room

Before Commissioners: Thomas E. Wright, Chairman
Michael C. Moffet
Joseph F. Harkins

In the matter of the Application of	)	
Atmos Energy for Adjustment of its	)	Docket No. 08-ATMG-280-RTS
Natural Gas Rates in the State of Kansas.	)	
	)	
	)	

Responsive Brief of The Citizens' Utility Ratepayer Board (CURB)

Niki Christopher #19311
Citizens' Utility Ratepayer Board
1500 S. W. Arrowhead Road
Topeka, Kansas 66604
Telephone: (785) 271-3200
Facsimile: (785) 217-3116

Table of Contents

I. Introduction . . . 1

II. The circumstances demand more than just a settlement . . . 2

III. The fairness of the settlement process . . . 8

IV. Depreciation issues . . . 13

- **A. Staff's and CURB's depreciation experts developed accord on most issues. . . . 14**
- **B. Over-collection from current ratepayers will continue with settlement . . . 15**
- **C. Creating a regulatory liability will protect ratepayers . . . 17**

V. Rate of return . . . 18

VI. Miscellaneous issues . . . 24

- **A. CURB's gas-in-storage adjustment . . . 24**
- **B. Staff's weather normalization adjustment . . . 25**
- **C. Staff's adjustment to eliminate incentive program costs . . . 26**

VII. Conclusion . . . 27

BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

In the Matter of the Application of Atmos Energy for Adjustment of its Natural Gas Rates in the State of Kansas.	)))	Docket No. 08-ATMG-280-RTS

RESPONSIVE BRIEF OF THE CITIZENS' UTILITY RATEPAYER BOARD

I. Introduction

A settlement that represents a negotiated compromise of two parties is not necessarily reasonable. If a settlement is not supported by substantial competent evidence, then it cannot set just and reasonable rates. If a settlement does not set just and reasonable rates, then it does not conform with applicable law. If a settlement does not conform with applicable law, then it is not in the public interest.

Furthermore, some outcomes are more reasonable than others. Just because a settlement is supported by the evidence and is, for all purposes, reasonable, it doesn't mean that the settlement cannot be improved with additional terms, or rejected altogether in favor of a decision that more reasonably resolves the outstanding issues of the case. For example, in this case, the Commission may be able to devise a final order that incorporates the basic terms of the settlement, yet addresses the concerns of other parties. If the settling parties insist on scuttling the settlement because the Commission finds that the settlement requires the addition of terms that address all of the pertinent issues, was the settlement really all that reasonable in the first place? Only the Commission can answer this question for itself.

CURB submits, however, that whether or not the settlement reached by Staff and the company can be found to be legal and reasonable, it is more reasonable to address key

issues that the settlement would leave unresolved in this case—especially because it has been so long since these issues have been addressed. Sometimes it is simply more reasonable to take action on long-deferred decisions than to leave them for another day. Sometimes it is simply more reasonable to add protective measures to a bare-bones settlement agreement than to leave the terms as they are. Sometimes, being satisfied with mere reasonableness is not enough. This Commission has the opportunity in this docket to resolve several important issues that would make the terms of the settlement even more reasonable and fair to all the parties.

An examination of the record in this case will find many claims by the company and Staff that their settlement is in the "public interest," but there is not one explanation of what the "public interest" is. CURB, as the statutory representative of the customers in this case, submits that the interest of the public is in just and reasonable rates. The interest of the public is in seeing customer rates moderated because they are carrying more and more of the risk that the utility's costs will increase. The interest of the public is in seeing this Commission recognize current trends in depreciation regulation and accounting that protect consumers from losing the money they have paid the utility for its future costs. The interest of the public is in seeing this Commission ensure that the rate of return allowed the investors of a utility reflects current economic conditions. Ultimately, however, only the Commission can decide what the public interest really is: it is uniquely positioned to make such determinations

II. The circumstances demand more than just a settlement

Since the Commission last set a rate of return for a natural gas utility, the balance of risk between the utilities and the customers has shifted significantly. Utilities once bore most of the risk that costs would increase in between rate cases. Now, customers now bear most of the risk that the utilities' costs will increase between rate cases. The following methods of expediting and ensuring recovery of increased costs from customers have all been implemented by the legislature since the Commission last set a rate of return for a natural gas utility:

- Property tax surcharge: allows utility to pass through increases to customers. K.S.A. 66-117(f) (1997)
- Construction work in progress: allows inclusion in rates of costs of incomplete capital projects in rates. K.S.A. 66-128 (2001)
- Right-of-way and franchise fees surcharge: allows utility to pass through increases to customers. K.S.A. 66-1231 (2002)
- Security expenditures: allows expedited, confidential proceedings for cost recovery with no identification of charges on bills. K.S.A. 66-1233 (2002)
- Gas safety and reliability surcharge: allows such costs to be passed through to customers. K.S.A. 66-2201 (2006).

Additionally, the following Commission proceedings resulted in the approval of measures for shifting the risk of increased costs away from Atmos and/or protecting its revenues from decreases during the period since the Commission last set a rate of return for a natural gas utility:

- 01-GRLG-886-PGA (2002): hedging program attempts to protect customers of Greeley Gas (predecessor to Atmos) from spikes in price of gas; costs paid by customers whether program is successful or not.
- 03-ATMG-539-TAR (2003): weather normalization adjustment protects Atmos from decreases in revenues attributable to unusually warm winter weather
- 05-ATMG-643-GIG (2005): purchased gas adjustment (PGA) surcharge to pass through changes in costs of gas to customers.
- 05-ATMG-643-GIG (2005): allows Atmos to pass through to customers the gas cost portion of uncollectibles in the PGA.
- 04-GIMX-651-GIV (2005): approval of use of credit cards to pay utility bills; shifts

risk of lost revenues to third party.

Although several of the measures cited above provide benefits to customers as well as the utilities, at least some of the time—the ability to use credit cards for utility payments is a convenience for some customers and may provide the only opportunity for them to avoid disconnection, for example—the benefits of these changes in the regulatory regime accrue to the utility whether the customer actually benefits or not. At the very least, many of the financial risks once born almost entirely by the utility are now born by ratepayers. If gas costs go up—customers pay. If a city raises its franchise fees—customers pay. If a customer moves to Florida without paying its arrearage owed to Atmos, the other customers pay: the gas cost (about 80% of the uncollectible bill) is recovered by Atmos through the PGA; the balance is recovered through the allowance for uncollectibles included in base rates. If the winter is abnormally warm and Atmos sells less natural gas to its customers—customers pay for those lost revenues through the weather normalization adjustment. (Admittedly, the customers receive an offset to the cost of gas when weather is abnormally cold, but the cost to them of using increased volumes generally outweighs the weather normalization benefit.) If the company has to move a gas main because of a highway project—customers now pay through a surcharge soon after the expenses are incurred, rather than through an averaged allowance for such costs in base rates. If the hedging program costs customers more than it reaps in benefits of moderated gas prices—customers pay anyway.

In Atmos' 2006 annual report included with its application, it stated that "more than 90 percent of our customer margins are now substantially insulated from the effects of adverse weather. This has been a primary goal to help safeguard our earnings." (App.,

Vol. 1, Sec. 13, on 2nd page of section entitled "Dear Fellow Shareholder"). Obviously, although weather norm adjustments can benefit customers, the company clearly views weather norm adjustments as a significant benefit to the company.

On page 4 of its September 30, 2006 Form 10-K (App., Vol. 1, Sec. 13), Atmos states that "Our overall strategy is to: deliver superior shareholder value, improve the quality and consistency of earnings growth, while operating our natural gas utility and nonutility businesses exceptionally well and enhance and strengthen a culture built on our core values." On page 16 of that same document, Atmos states that, "Our current rate strategy focuses on seeking rate designs that reduce or eliminate regulatory lag and separate the recovery of our approved margins from customer usage patterns due to weather-related variability, declining use per customer and energy conservation, also known as decoupling." It also notes that the company is "directing capital spending to jurisdictions that permit us to recover our investment in a timely manner." (*Id.*). So, instead of making decisions about where capital spending is needed based on whether the expenditure is useful to customers in that jurisdiction, the company is making decisions on capital spending based on where the expenditure will be recovered the quickest. This method of determining where capital investments will be made does not appear to be consistent with the obligations of a public utility. Overall, it appears that the major strategies of Atmos are focused on providing enhanced benefits for shareholders.

It is worthy to note that the company's stated goals and strategy do not include reducing costs to customers, allowing customers to economically benefit from their efforts to consume less gas, or educating their shareholders to moderate their earnings expectations in light of current market conditions. Perhaps these goals are subsumed in

strengthening a "culture built on Atmos' core values," but it's anybody's guess what that really means. It seems clear, however, that Atmos is working hard to ensure that revenues are recovered from customers earlier and more often, and working hard to ensure that customers pay more and more for less and less gas. It is also working hard to ensure that whenever the company's costs increase, the task for Atmos will simply be to ensure that the increase is properly recovered from customers through the appropriate surcharge, rather than trying to operate more efficiently to maintain earnings.

Once upon a time, natural gas utilities faced two major risks: the risk that natural gas costs would increase faster than their ability to secure a sufficient rate increase, which would erode profits; and that the winter would be unusually warm, which would reduce revenues. Those risks are no longer their burden: they are the customers' burdens now. Other risks that utilities faced—uncollectible bills, extra costs incurred when public improvement projects necessitate moving a main or when the government mandates greater security at utility plants, higher taxes or franchise fees—are no longer their burdens, either. So why do these utilities insist on the same level of returns that they received back when they actually bore those burdens?

That, precisely, is one of the main reasons why CURB declined to join the settlement. It has been far too long since this Commission set a rate of return for a natural gas utility. There is a good reason why natural gas utilities in Kansas have been willing to settle their rate cases in the last ten years, often at half the revenue or less than they requested, and with stipulations that their depreciation rates should remain the same. It is clear that they have benefited from such settlements, or they wouldn't keep settling. For years, utilities have promised that reducing their risks would result in savings for

customers. But so long as rates are allowed to increase without rates of return being determined, no one can know if those savings have materialized or not. It appears to customers that they are bearing most of the risk, without seeing any reduction in rates at all.

The Commission and the legislature have approved numerous risk-reduction mechanisms, but when the experts point out that ratepayers are at risk of losing the benefit of their contributions to future removal costs, or that the current generation of ratepayers is bearing more than their share of such costs, who will speak up for them, if not CURB? Staff, which claims to represent the balanced interests of shareholders and ratepayers, supports a settlement that does nothing to protect ratepayers from such risks, even though it would not add a dime to the company's costs. The Staff claims to represent the interests of the public, but supports a settlement that does nothing to ensure that ratepayers will pay the lower returns that the companies predicted when they convinced the legislature and the Commission to make the decisions that placed the bulk of the utilities' risks on the customers' shoulders. The Staff's, own finance expert's calculation of the appropriate rate of return was only two-tenths of a percent apart from that of CURB's expert. Staff's depreciation expert had no quarrel with the methodology and recommendations of CURB's depreciation expert. Yet Staff decided it was just and reasonable to settle with the company, with whom it had significant differences on both issues, rather than litigate in unity with the only party in this case who actually represents the interests of the ratepayers, and whose positions on the major issues most closely resembled that of Staff.

How can the public interest be served when the Commission goes ten or fifteen years without making a key decision such as what rate of return is appropriate for a natural gas utility? How can the public interest be served to ignore the fact that the regulatory regime has changed dramatically in the interim? How can the public interest be served in ignoring the obvious—that interest rates are lower and the economy is slower than it has been in several years? How can it be in the public interest to allow the company to over-collect removal costs from customers, and choose not to protect their contributions by creating a regulatory liability? Is it in the public interest to allow such issues to remain undecided, even if deciding them would not harm the parties to the settlement? If anyone is representing the public interest in this docket, it is CURB, in choosing to oppose the settlement and insist that such key decisions must be made by the Commission more than once in a decade or two. But only the Commission can determine, in the end, what will serve the public interest.

III. The fairness of the settlement process

Although the company and Staff were adamant that the process leading up to the hearing, and the hearing itself, gave ample opportunity for CURB to be heard on its reasons for opposition to the stipulation and agreement, CURB's view is that the potential for the process to be fair was hindered considerably by the procedural schedule. There was simply too little time between the filing of the company's rebuttal and the date of the hearing to allow the parties adequate time to have settlement talks, prepare settlement documents and testimony, make informed decisions on the waiver of testimony and

issues at the prehearing conference, and then prepare for the hearing with the full record in hand.

Furthermore, the assertions of the company and Staff that CURB was included in all settlement discussions are simply not true. As noted by CURB witness Andrea Crane, at the second settlement conference it was obvious to her that Staff and the company had discussed a new proposal for the revenue requirement since the first settlement conference. (Crane, Prehearing Tr., at 212: "I certainly got the impression that there had begin [sic: should read "been"] quite a bit of negotiation between the first one I participated in and the second one . . . . if you'll recall, the two parties that eventually settled walked in, walked in and basically had a number."). Counsel for CURB specifically recalls that a member of Staff at that meeting stated that the revenue requirement Staff was proposing for settlement had been discussed earlier with the company. Since it was an entirely different number than the number discussed at the previous settlement conference at which CURB had been present, the only possible conclusion that CURB could make was that Staff and the company had met since the last settlement conference. Although the company and Staff went to great pains at the evidentiary hearing to establish that CURB had been included in all settlement talks, CURB could only conclude that it had not.

For another example, the company and Staff notified CURB they had reached a settlement less than an hour before the prehearing. (Prehearing Tr., at 12). At the point where the settlement discussion had ended a couple of hours earlier that day, the company had made what it characterized as a "final" offer of settlement: counsel for the company explicitly stated that all the parties had to accept all of the settlement terms

offered, or the company would litigate its filed case. (*see* Flaherty, Prehearing Tr., at 15: ". . . we were thinking that we should do an all-or-nothing deal." CURB immediately rejected a key term, made a counteroffer, and the parties broke to allow the company to consider CURB's counter offer.

Counsel for CURB waited over an hour in expectation that she would receive a call to reconvene the settlement conference or hear that the company chose to litigate the case. Instead, thirty minutes before the prehearing, CURB received a phone call from Staff informing CURB that Staff had settled with the company. Shortly thereafter, counsel for the company visited CURB to say that the company had met with Staff during the break, and settled with Staff on the exact same terms that it had offered in its so-called "final" offer that it had unequivocally stated was contingent on a unanimous settlement. (Prehearing Tr., at 15: "Right before lunch we decided to see if we could reach agreement with the Staff based upon the terms and conditions that Staff had provided to us, which were the same, basically, terms and conditions that we had provided or been provided during the conferences . . ."). So CURB was left out of two settlement discussions between the company and Staff before a settlement was reached.

Counsel for the company revealed that it had learned from Staff that one of the main reasons CURB wanted to litigate the case was to get an order with an established ROE. So counsel for the company offered CURB a token concession to settle: a statement in the settlement that the company had assumed a specific ROE when deliberating whether to accept the revenue requirement agreed to in the settlement. Since the statement would have no legal effect and was an insubstantive offer that did not address any of CURB's concerns, CURB declined to join the settlement. However,

CURB was somewhat disturbed to hear that Staff had revealed that information to the company, because Staff had learned that fact in confidential discussions with CURB prior to entering into the settlement discussions with the company. CURB had spent considerable time and effort trying to persuade Staff that it was not in the interests of either Staff or CURB to enter into settlement discussions with the company because of the strong similarities in their positions on depreciation and the rate of return.

So, contrary to Staff's and the company's assertions, CURB was left out of at least two key discussions between Staff and the company during the course of settlement discussions with the company. Additionally, the company misrepresented its final offer as contingent on a unanimous settlement. Furthermore, Staff revealed information to the company that it had received from CURB in confidential discussions about litigation strategy prior to the settlement discussions. Thus, if CURB was not impressed with the integrity or fairness of the settlement process, it is understandable.

The compressed procedural schedule created problems at this point in the proceedings. When the parties went into the prehearing less than fifteen minutes after the company left CURB's office, the specific terms of the settlement were not in writing. CURB told the hearing officer it felt very prejudiced by being forced to say which witnesses and issues it would be willing to waive without having a signed agreement in hand. (Prehearing Tr., at 13, 21). Even Staff argued at the prehearing that until the settlement agreement was in writing, it did not want to agree to waive certain issues or witnesses. (Prehearing Tr., at 11). Yet the parties were, indeed, pressured to develop a list of contested and uncontested issues at the prehearing. Although the parties were permitted to submit revisions before the hearing officer issued the final prehearing order,

the prehearing order was issued before the documents supporting the settlement were provided to CURB.

Further delays occurred. The filed settlement agreement and the company's testimony in support of the settlement weren't made available to CURB until 4:45 p.m. on Friday, the last business day before the hearing started on Monday. But at least they were provided to CURB on the date promised: Staff's testimony in support of the settlement wasn't made available to CURB until late Sunday morning, and then only in response to a request from CURB. None of these documents were available on the KCC's docket website through the weekend. Additionally, Staff failed to provide CURB a copy of Staff's motion for administrative notice that was filed on Friday. It was not served on CURB until the hearing, and was also not available on the KCC's website until after the hearing had commenced. While it may be that these delays were simply inevitable because of the compressed procedural schedule, that's no comfort to the party trying to prepare for litigation with less than a complete record in hand.

Normally, the parties are not afforded an opportunity to provide their impressions of the settlement process, but since the Commission specifically asked the parties to address whether the settlement process was fair, CURB will be frank in stating that it was not particularly satisfied with the process. CURB further believes that the delays in getting the settlement documents on the record and made available to CURB compromised its ability to make informed waivers at the prehearing conference and to prepare its case opposing the settlement. CURB believes that the procedural schedule contributed to these problems.

Therefore, CURB strongly urges the Commission in future rate cases to provide more time between rebuttal testimony and the prehearing conference, and between the prehearing conference and the hearing. If the parties are interested in discussing settlement, there should be sufficient time to schedule settlement conferences, to get the terms of any resulting settlement into the record prior to the prehearing conference so that the parties may make informed waivers of issues and witness testimony, and to allow the parties sufficient time to prepare for the hearing with a complete record. Four days between company rebuttal and the prehearing conference is simply not enough. If a non-unanimous settlement is reached, the opposing parties should have more than 24 hours to review the filed terms of the settlement and supporting testimony before going to hearing. While CURB recognizes that the duration of a rate case is limited by the statutory deadline, the compression of time between rebuttal and the evidentiary hearing results in parties attempting to prepare to litigate against documents they haven't seen yet. Allowing more time in this key juncture of the ratemaking process would enhance the fairness to all parties.

IV. Depreciation issues

One reason why CURB opposes the settlement is because it fails to address key depreciation issues. First of all, the settlement allows the company to continue charging its old depreciation rates under its old calculation methods. These rates haven't been revised for several years, and are over-collecting for future costs from current customers. Secondly, the settlement fails to protect ratepayers by creating a regulatory liability to protect the amounts over-collected.

A. Staff's and CURB's depreciation experts developed accord on most issues.

Prior to the hearing, CURB's consultant, Michael Majoros, in response to answers received in response to data requests from Staff's depreciation consultant Mr. Dunkel, revised his initial calculations based on a normalized allowance on cost of removal to reflect the use of the net present value approach, which Staff's consultant Dunkel had proposed. (Tr. Vol. 2, at 239). Mr. Majoros testified that they were equivalent approaches, and he was willing to make revisions using Dunkel's approach. (*Id.*). The only substantive difference in their approaches was that Mr. Majoros applied the net present value approach to legal and non-legal asset retirement obligations, and Mr. Dunkel only applied it to legal retirement obligations. (*Id.*, at 241).

Mr. Dunkel, discussing a data response he had provided to CURB, said that he had no objection to Mr. Majoros' revised approach. (Tr., Vol. 2, at 346). "I stand by that answer now, by the way," he said. (*Id.*). Further, he had proposed the same approach as Majoros' in three Maryland dockets. (*Id.,* at 347). He said that the approach had been adopted in one docket, had received approval from the hearing examiner but had not yet been approved by the commission in another docket, and that a final decision was pending in the third. (*Id.,* at 347). So Staff's witness not only had no objection to Mr. Majoros' approach, but had recently advocated the same approach in three other cases. It was clear that Mr. Dunkel considered the differences in methodology negligible.

Mr. Dunkel noted that he was neutral on the issue of service lives, as well. (*Id.,* at 349). He had not addressed service lives in his study, so he prepared two sets of

schedules, using Mr. Majoros' lives in one, and the company's lives in the other. (*Id.*). He therefore had no objection to adopting Mr. Majoros' position on service lives.

Therefore, two of the three depreciation experts in this case were agreed that the present value method of calculating depreciation rates for future removal costs prevents over-collection from current ratepayers, but allows the company full recovery of its removal costs over the life of the asset. Neither expert felt that their differences were significant, and in fact, felt the differences in their methods were negligible. With such accord between these experts, who worked hard to develop accord and agreement in their positions, it was inexplicable to CURB why Staff chose to settle with the company and allow depreciation rates to remain unchanged in the case.

B. Over-collection from current ratepayers will continue with settlement

Mr. Majoros explained that he was very concerned about the settlement's adoption of the company's existing depreciation rates, which over-collected $10 million in 2006 from customers for future costs of removal. (*Id.*, at 244). By over-collection, he meant that the company collected $10 million more that year for removal costs than the company actually spent for removals. (*Id.*) He illustrated the problem for the Commission at the hearing, demonstrating that the company's inclusion of future inflation in current rates over-collects from the current generation of ratepayers, and explained how the over-collection could be avoided if the Commission adopted the present value method. (*Id.,* at 301 – 03; *see* CURB Exh. 6). Mr. Majoros said that, while no accounting method for removal costs would provide an exact match-up between the benefits enjoyed by a particular generation of ratepayers and the payments they make for

removal costs, "the present value approach to future cost of removal provides at least a sound theoretical match-up." (*Id.*, at 298). Mr. Majoros explained that the present value approach uses a five-year average to estimate the present value of future removal costs. (*Id.*, at 277). He said theoretically, the customer who comes onto the system in year 5 pays his fair share of costs of removal. (*Id.*).

Mr. Majoros demonstrated how the straight-line amortization used by the company front-loads the amounts collected from ratepayers by including future inflation in current rates, while the present value method adjusts for inflation over time to create intergenerational equity among the various generations of ratepayers who contribute to future costs. (*Id.*, at 302; see CURB Exh. 6). He said that it violated the ratemaking principal of intergenerational equity to include inflation that has not occurred yet in current rates. (*Id.*, at 303). He said the company's over-collection of $10 million in removal costs in 2006 over the amount the company spent on removal is a perfect example of what happens when the company includes future inflation in calculating current depreciation rates. (*Id.,* at 303).

Mr. Majoros explained that using the present value method would include the appropriate amount of inflation for each generation, because it allows for adjustment of the accruals for future removal costs in successive rate cases to account for then-current inflation, just as other parameters are updated in rate case reviews. (*Id.*). He noted, however, depreciation rates must be reviewed periodically to prevent generational inequity. He pointed out that in the 2005 Westar case, Staff witness Holloway had joined Majoros in opposing the inclusion of future inflation in calculating current depreciation rates. (*Id.*, at 297-98). Further, the Kansas Court of Appeals, in rejecting Westar's

terminal net salvage claim in that appeal, had called the inclusion of future inflation in current rates "troubling." (*Id.*).

Adopting Mr. Majoros approach would ensure that each generation of ratepayers will contribute to future costs of removal of assets that benefit them, at a rate of inflation that reflects the present value of the cost of removal of those assets to that generation of ratepayers. The company will receive the full cost of removal by the end of the assets' depreciated lives, but will not over-collect from the earlier generations of ratepayers, as the company does now.

C. Creating a regulatory liability will protect ratepayers

Mr. Majoros also expressed great concern that the settlement does not reclassify the $10 million over-collected as a regulatory liability, which would essentially label that amount as "owed to ratepayers" until it is spent on its intended purpose. (*Id.*). He noted that the telephone industry had taken $11.5 billion into income that it had collected from customers for future costs of removal when the industry was moved from cost-plus regulation to price regulation, and that it was important to protect ratepayers from such results. (*Id.*, at 245). Assuming the Commission adopts the settlement without addressing this issue, the company will continue to over-collect annually, and those excess amounts collected will not be protected in future years, either.

Mr. Majoros further stated that the reclassification and amortization of the regulatory liability had zero revenue requirement impact. (*Id.*, at 293). Mr. Dunkel agreed. (*Id.*, at 356). Mr. Majoros also stressed that the KCC was the only ratemaking regulatory body that is in a position to protect ratepayers in this regard. (*Id.*). He pointed

out that the KCC had created a regulatory liability for ratepayers in the 2005 Westar rate case, as proposed by Staff and CURB, and that the company had not appealed this issue. (*Id.*, at 294).

Protecting the amounts over-collected in Atmos' depreciation rates by classifying them as a regulatory liability, as the KCC did in the most recent Westar rate case, will guarantee that Atmos' ratepayers will be credited for their contributions to future costs, even if the regulatory regime changes, as it did for the telephone industry. The reclassification is revenue-neutral, and thus could be created as an addendum to this settlement without changing the revenue requirement at all. In fact, even if the Commission rejects Mr. Majoros' approach to calculation of depreciation rates and approves the settlement's continuation of Atmos' current depreciation rates, the Commission could still create a regulatory liability to protect customers without impacting any of the substantive terms of the settlement. CURB urges this Commission to protect the ratepayers of Atmos as it protected the ratepayers of Westar.

V. Rate of return

CURB declined to join the settlement, in part, because the agreement does not explicitly state the return on equity that will be allowed to Atmos. As noted above, it has been about fifteen years since this Commission set a return on equity (ROE) for Atmos or its predecessors, and about 10 years since the Commission has set one for any natural gas utility in the state. (Tr. Vol. 1, at 67 - 68). The regulatory regime has been altered significantly in the interim, shifting more and more of the risk of rising costs to ratepayers. Additionally, the economy is significantly slower than it has been in recent

years, and returns and interest rates significantly lower. If an increase is granted through a black box settlement, it will be impossible to determine whether ratepayers are reaping the reduced rate impacts that they were assured would result as a consequence of bearing more of the risk if the return on equity is unstated.

An explicit ROE determination in this case also will set forth the level of return allowed Atmos, and several other Kansas gas utilities under K.S.A. 2006 Supp. 66-2201 *et seq.,* the Gas Safety and Reliability Surcharge (GSRS). The settlement in this case sets the ROE for Atmos' GSRS equal to the average cost of equity "used or agreed to be used by the commission in calculating the GSRS for the other Kansas gas utility companies" (*Joint Motion to Approve Joint Stipulated Settlement Agreement*, at para. 10). However, the Commission has not affirmatively decided the appropriate ROE for any investor owned natural gas utility in Kansas for a number of years. Each recent gas utility rate case has resulted in a settlement. And each settlement has contained language similar to the Atmos settlement language, linking the return for GSRS purposes to the average allowed other natural gas utilities. Two exceptions are the Kansas Gas Service case that did contain a value of 10.2% ROE for GSRS purposes, and a Midwest Energy case that set an overall return for GSRS, but did not specify an ROE. It should be noted that both the KGS and the Midwest cases were also settlements. Since the GSRS calculation for all the Kansas gas utilities are now mutually dependant because of the ROE provisions, CURB believes that it is imperative that the Commission set forth its independent determination of an appropriate ROE in this case. The new GSRS charges that consumers will pay must be calculated using an ROE figure that is based on current economic conditions, as determined by the Commision

Further, assuming that the Commission accepted the proposed revenue requirement in the settlement, ordering an appropriate ROE as an addendum to the settlement would not alter the amount of recovery to the company or of the rates paid by customers. It would, however, establish a base line by which the fairness of the settlement can be assessed in relation to current economic conditions and the reduction of risk that natural gas utilities have enjoyed in recent years and would set a baseline ROE for use is GSRS calculations.

Andrea Crane, CURB's accounting and financial consultant, proposed an ROE of 9.41%. This was very similar to Staff's recommended ROE of 9.6%, and near the midpoint of Staff witness Gatewood's recommended ROE range of 9.1% to 10.1%. (Tr. Vol. 2, at 198). Although Ms. Crane and Mr. Gatewood disagree on the validity of using the arithmetic versus the geometric mean in CAPM model calculations, and whether the ROE should cover flotation costs, they came to very similar conclusions on what the appropriate rate of return should be for Atmos. (*Id.*, at 198 – 99). Although Mr. Gatewood's DCF results of 8.27% to 9.04% were lower than Ms. Crane's, their final ROE recommendations were similar. (*Id.*, at 325). Both appear to agree that using more than one model provides useful information for setting an appropriate ROE.

There are two differences worth noting between Ms. Crane's recommendation and Mr. Gatewood's. First is that Mr. Gatewood assumed a somewhat optimistic 12.3% long-term growth rate in his CAPM model. (*Id.*, at 328). On cross-examination, Mr. Gatewood testified that in the shorter time horizon there is less of a chance you would see something in the 12% range for annualize return. But in the longer time horizon, Mr. Gatewood testified it "wouldn't surprise me if, if you reached something in the 12

percent level". (*Id.*, at 329) However, in a recent Westar rate case, when asked "as a financial expert testifying in this proceeding, do you expect a 12.4 percent return in the market going forward? Is that reasonable?" Mr. Gatewood came to a different conclusion than he does now; responding that "I think 12.4 is probably abit high". (Tr. Vol. 10, at 2142, *KCC Docket No. 05-WSEE-981-RTS*). By any measure, Mr. Gatewood is using a long-term growth figure in his CAPM model in this case that is at the very high end of the range of reasonable expectation. Ms. Crane uses a more modest, but yet still reasonable 10.4% long-term annualized growth rate in her CAPM model.

Second, Mr. Gatewood's DCF analysis results in an ROE range from 8.27% to 9.04%. (Gatewood Direct, Schedule AHG-2) In arriving at these DCF results Mr. Gatewood removed selected companies with "abnormally low" DCF returns from his calculations, but did not remove companies with abnormally high DCF returns. (Tr. Vol. 2, at 325 – 26). The result is a DCF calculation that is biased upward. Mr. Gatewood admits "that if you want to leave all of the results in, the averages for each of these DFC groups would be lower…and that would certainly pull down the range" of DFC results. (*Id.*, at 326 – 27)

Adjusting Mr. Gatewoods results for one or both of these two issues will directly lower Mr. Gatewood's recommended ROE range. Mr. Gatewood calculates a simple average of his CAPM and DCF results to arrive at his recommended ROE range of 9.1% to 10.1%, and his overall ROE recommendation of 9.6% in this case. The 9.6% return is simply the midpoint of his recommended ROE range. Lowering either the long-term growth rate in his CAPM model, or using all of his DCF results rather than just selected results, or both, has the direct effect of lowering Mr. Gatewood's recommended DCF

range, and presumably his recommendation based on the midpoint of that range. Even if the Commission does not make these two adjustments, the Commission can, and should, move to the lower portion of Mr. Gatewood's ROE range. After questioning, Mr. Gatewood said he would be comfortable with any ROE within his recommended range, even if it were at the lower end. (*Id.*, at 333 - 34).

Looking at the most recent ROE set by the Commission, Ms. Crane said that the 10% ROE granted Westar Energy three years ago would be inappropriately high now, given the slowing economy. (*Id.,* at 210). Despite the slowing economy, Mr. Gatewood's ROE recommendation in this docket was quite similar to the recommendation he made in the Westar case. (*Id.*, at 316). However, both experts' recommendations weren't far apart. By contrast, the company said that it assumed an ROE of 10% to 10.25% in assessing whether it would adopt the settlement proposal. (*Testimony of Joe Christian on behalf of Atmos Energy in Support of the Settlement Agreement*, at 6). Its original filed position requested an ROE of 11%, despite the fact that the company's witness came up with DCF results quite similar to those of Ms. Crane. (Tr. Vol. 2, at 210).

Assuming that the Commission adopted Ms. Crane's recommended ROE, but also adopted Mr. Gatewood's recommendation that 10 basis points be added to the ROE for flotation costs, this would result in an ROE of 9.51%--roughly the midpoint range between CURB's and Staff's positions. Conversely, if the Commission rejected Mr. Gatewood's inclusion of flotation costs, the midpoint of CURB's and Staff's recommendations would be 9.451%. (*Id.*, at 322). In fact, any combination of Mr. Gatewood's and Ms. Crane's recommendations would result in a lower ROE than the

company's requested ROE of 11%, or even the 10% to 10.25% ROE that the company "assumed" in assessing the settlement. Although it is a mistake to ignore the fact that moving a few basis points one way or the other can impact the revenue requirement significantly, there is so little difference in this case between Staff's and CURB's filed positions that an ROE based on either of their recommendations, or a combination of their recommendations, would be a reasonable choice.

So the Commission first must determine whether it is reasonable to accept a settlement that does not establish the ROE for Atmos. Given the downturn in the economy, and the extraordinary shift of the apportionment of risk from the shareholders to the customers during the fifteen years since an ROE was set for the company, and the new GSRS requirements, CURB believes that it would be unreasonable for the Commission to adopt the settlement without setting an ROE. Even the company's witness who testified in favor of the settlement said that it "couldn't hurt to have a stated amount." (Tr. Vol. 1, at 70).

If the Commission determines it is not reasonable to leave the ROE undetermined, then it must determine what the appropriate return on equity for Atmos will be. Again, given the recent and precipitous deterioration in the economy, the ROE should be lower than the 10% it ordered three years ago for Westar. Additionally, consideration of the substantial reductions of risk that Atmos has experienced in the last decade should be recognized with a lower-level ROE. If one also takes into account that two of the three parties made a good case for setting the ROE within a few basis points of 9.5%, then an ROE for Atmos in that range would be supported by the evidence, and be just and reasonable.

VI. Miscellaneous issues

A. CURB's gas-in-storage adjustment

CURB recommended a reduction to rate base based on Ms. Crane's adjustment to the company's gas-in-storage claim. Ms. Crane noted that companies have an incentive to increase gas in storage because it is part of the rate base, (Tr. Vol. 2, at 204), on which companies earn a return. She noted that she doesn't always make a downward adjustment based on storage, however. (*Id.*). She said, in this case, that she used a three-year average to determine a reasonable storage volume, and based her adjustment on that calculation. (*Id.*). She noted that in a recent Atmos case in Tennessee, a similar adjustment had been made as a part of a settlement. (*Id.*).

Ms. Crane submitted a revised Schedule ACC-10 at the hearing to correct two errors that occurred when she transferred her calculations to the schedule containing the gas storage adjustment. (Tr. Vol. 2, at 175). Although the Staff attempted to establish that Ms. Crane had erred in calculating the three-year storage average volumes on her revised schedule, it was ultimately determined through cross-examination that Staff simply misunderstood Ms. Crane's methodology. Although she had not erred, Ms. Crane did not object to Staff's preferred methodology, and agreed to recalculate her numbers using Staff's method. The result increased CURB's revenue recommendation by $86, 871.

Staff was the party that pressured Ms. Crane to make the adjustment for gas storage in her revenue requirement, not the company. It was apparently more important to Staff that Ms. Crane adopt Staff's methodology than to protect ratepayers from the

increase in rates that would result from using Staff's methodology rather than Ms. Crane's.

B. Staff's weather normalization adjustment

Staff also recommended an adjustment concerning the company's weather normalization calculations, which increased the company's revenue requirement by approximately $933,000. This is a perfect example of why Staff's claims that it represents the customers as well as the company ring hollow. CURB questions whether it is appropriate for Staff, which claims to represent the consumers as well as the company, to argue that the company should receive almost a million dollars more than it asked for in its application for a particular expense, simply because Staff prefers its own methodology. This was similar to Staff's insistence that Ms. Crane adopt Staff's methodology on gas storage, but in this instance Staff's adjustment for weather normalization was much larger. Staff is supposedly a neutral party "uniquely positioned" to balance the interests of the company and its customers, but advocated for an outcome that the company hadn't requested and the customers didn't want. The only party who would have been satisfied with the outcome would have been Staff, who believes that its own methodology is superior.

As a "balancer" of interests, Staff could have taken the approach of a neutral party, and simply accepted the fact that, although the company uses a method that Staff doesn't prefer, it is less expensive to consumers than Staff's preferred method. That would have been a fair balancing of the interests of the company and the customers, who both would have been satisfied with the outcome. Instead, Staff was so convinced of the

superiority of its own methods that it was willing to make customers pay $933,000 more for weather normalization each year for the privilege of being overcharged under Staff's "superior" weather norm parameters. So Staff's claims that it takes a balanced approach simply do not hold water on this particular issue. One can only hope that in future negotiations over Atmos' weather normalization program that Staff actually takes a balanced approach rather than simply being an advocate for its own methodology.

C. Staff's adjustment to eliminate incentive program costs

Staff did better, however, in protecting the public interest in opposing the company's incentive mechanisms, which increase compensation to employees primarily based on earnings per share. Although Atmos witness Harmon said that an employee's performance must meet expectations for the employee to be eligible for a bonus plan, the sole criteria for receiving the variable pay plan, or VPP incentive, is expressed in earnings per share. (Tr. Vol. 1, at 131, 132). The VPP plan and the MIP incentive plans have been paid consistently since they were implemented in 2001. (*Id.*, at 137). Its long-term incentive plan also depends primarily on earnings-per-share targets. (*Id.*).

Although the company pointed out that the KCC has approved various employee incentive plans in previous dockets, the approved plans explicitly included criteria that would encourage individual employees to perform well on behalf of customers as well as shareholders. The plan that the KCC approved for Utilicorp is based on individual performance, and can result in lower total cash compensation than the previous year if the employee doesn't meet performance criteria. (Tr. Vol. 1, at 52 – 53). The Aquila plan approved by the KCC provided that employees must meet specific metrics of service

reliability, safety, customer service and effective use of capital. (*Id.*, at 53). The KCC noted with approval that the Aquila plan balances the company's interests and the customers' interests. (*Id.*). Atmos' incentive plans simply lacked express provisions that indicated that employees were rewarded for serving customers' interests, and therefore did not meet the standard of plans previously approved by the KCC.

Staff therefore made an adjustment to remove these incentive plans from the revenue requirement of approximately $534,500. Although CURB did not make a similar adjustment, CURB does not oppose the adjustment, and agrees with previous KCC rulings that have only included incentive mechanisms in rates when they provide a balanced set of metrics that provide incentives for employees to perform well on behalf of customers as well as shareholders.

VII. Conclusion

CURB will not argue in this case that the settlement cannot be found to be reasonable and within applicable law. However, in considering the terms of the settlement, the Commission may reasonably find that the evidence in the record supports a conclusion that the settlement is not reasonable, because the settlement does not settle certain issues of importance to the customers of Atmos. Whether or not the Commission finds that the revenue requirement proposed by the settlement is reasonable, the Commission could reasonably determine that it is unreasonable to continue a ten-year hiatus on determining the appropriate returns on equity for natural gas utilities. The Commission could reasonably determine that the agreement to allow Atmos to continue with its current depreciation rates is unfair to the current generation of customers. The

Commission could reasonably determine that a regulatory liability should be created to ensure that ratepayers are protected from changes in the regulatory regime that could destroy their interest in contributions to future costs of removal. The Commission could reasonably determine that the revenue requirement should be adjusted to account for excessive gas in storage and to remove Atmos' incentive programs from rates. The Commission could reasonably accept some terms of the settlement, and reject others, finding that is not bound by the preferences of the settling parties. The Commission could reasonably provide guidance for future cases in determining the appropriate timing of the procedural schedule to ensure fairness to all parties. Finally, the Commission has the opportunity in this case to determine key issues that will, in their determination, provide the framework for defining "the public interest." CURB believes the evidence it has presented in this case supports its assertion that its position most closely represents the public interest. But only the Commission can decide.

CURB simply requests that the Commission exercise fairness in giving as much consideration to the evidence opposing the settlement as is does to the evidence supporting the settlement, and make a balanced decision that serves the interest of the parties and the public.

Respectfully submitted,

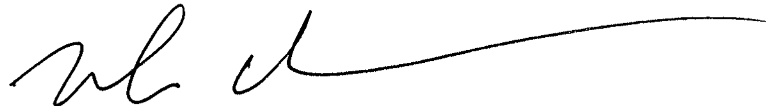
Niki Christopher #19311
Citizens' Utility Ratepayer Board
1500 S. W. Arrowhead Road
Topeka, Kansas 66604
Telephone: (785) 271-3200
Facsimile: (785) 217-3116

VERIFICATION

STATE OF KANSAS)
COUNTY OF SHAWNEE) ss:

Niki Christopher, of lawful age, being first duly sworn upon her oath states:

That she is an attorney for The Citizens' Utility Ratepayer Board; that she has read the above and foregoing document; and, upon information and belief, states that the matters therein appearing are true and correct.

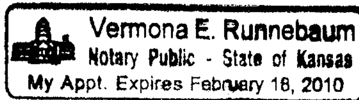


Niki Christopher

SUBSCRIBED AND SWORN to before me this 3rd day of April, 2008.

Notary Public

My Commission expires:



CERTIFICATE OF SERVICE

08-ATMG-280-RTS

I, the undersigned, hereby certify that a true and correct copy of the above and foregoing document was placed in the United States mail, postage prepaid, or hand-delivered this 3rd day of April, 2008, to the following:

* JAMES G. FLAHERTY, ATTORNEY
ANDERSON & BYRD, L.L.P.
216 SOUTH HICKORY
PO BOX 17
OTTAWA, KS 66067
Fax: 785-242-1279
jflaherty@andersonbyrd.com

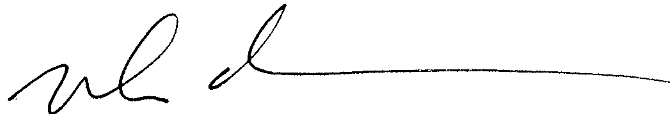
* JOE CHRISTIAN, RATES & REG. AFFAIRS
ATMOS ENERGY CORPORATION
PENN CENTER
SUITE 1800
1301 PENNSYLVANIA ST
DENVER, CO 80203-5015
Fax: 303-837-9549
joe.christian@atmosenergy.com

* DOUGLAS C. WALTHER, SR ATTORNEY
ATMOS ENERGY CORPORATION
P O BOX 650205
DALLAS, TX 75265-0205
douglas.walther@atmosenergy.com

* DANA BRADBURY, LITIGATION COUNSEL
KANSAS CORPORATION COMMISSION
1500 SW ARROWHEAD ROAD
TOPEKA, KS 66604-4027
Fax: 785-271-3354
d.bradbury@kcc.ks.gov
**** Hand Deliver ****

* PATRICK T SMITH, LITIGATION COUNSEL
KANSAS CORPORATION COMMISSION
1500 SW ARROWHEAD ROAD
TOPEKA, KS 66604-4027
Fax: 785-271-3167
p.smith@kcc.ks.gov
**** Hand Deliver ****

* WILLIAM DUNKEL, CONSULTANT
WILLIAM DUNKEL & ASSOCIATES
8625 FARMINGTON CEMETARY RD.
PLEASANT PLAINS, IL 62677
Fax: 217-626-1934
bdunkel@aol.com



Niki Christopher