

**BEFORE THE STATE CORPORATION COMMISSION STATE CORPORATION COMMISSION  
OF THE STATE OF KANSAS**

SEP 14 2007

**IN THE MATTER OF THE APPLICATION )  
OF ATMOS ENERGY CORPORATION )  
FOR REVIEW AND ADJUSTMENT OF ITS )  
NATURAL GAS RATES )**

**Docket No.**

 Docket  
Room

**08-ATMG-280-RTS**

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**DIRECT TESTIMONY OF**

**GARY L. SCHLESSMAN**

**FOR ATMOS ENERGY CORPORATION**

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1

**I. INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Gary L. Schlessman. I am President of Atmos Energy Corporation's  
4 ("Atmos" or the "Company") Colorado/Kansas division. My business address is  
5 1301 Pennsylvania Street, Suite 800, Denver, Colorado, 80203-5015.

6 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND,  
7 PROFESSIONAL EXPERIENCE AND CURRENT RESPONSIBILITIES.**

8 A. I hold a Bachelor of Arts degree in Business Administration from Fort Lewis College  
9 in 1979. Following graduation from college, I began my career with Atmos (formerly  
10 Greeley Gas Company "Greeley") as an apprenticed serviceman. Beginning in 1983  
11 and for the next ten years, I held a variety of management positions of increasing  
12 responsibility in marketing, safety, training and communications with Greeley.

1 I was named President of Atmos' Kansas and Colorado operations in 1993 a position  
2 I have held since that time. As President, I have responsibility of customer service,  
3 operations, regulatory and community relations and the financial performance of the  
4 division.

5 **Q. HAVE YOU EVER TESTIFIED BEFORE THE KANSAS CORPORATION**  
6 **COMMISSION ("COMMISSION")?**

7 A. Yes. I filed written testimony in Greeley's 1993 rate case, KCC Docket No.  
8 187,731-U and in Atmos' 2003 rate case, Docket No. 03-ATMG-1036-RTS.

9

10 **II. SUMMARY OF TESTIMONY**

11 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

12 A. My direct testimony has several purposes. First, I will provide an overview of Atmos'  
13 operations in the United States and in particular its operations in Kansas. Second, I  
14 will set forth the principal factors requiring Atmos to file this rate application. Third,  
15 I will address the Company's request for a Customer Utilization Adjustment ("CUA")  
16 mechanism which will compliment our existing Weather Normalization tariff  
17 ("WNA"). Fourth, I will address the Company's request for new tariffs related to the  
18 Company's Advanced Metering Infrastructure ("AMI") program and for a Gas  
19 System Reliability Surcharge ("GSRS"). Finally, I will introduce the other witnesses  
20 who will be providing support for the proposed rate increase and tariff changes.

1 **III. OVERVIEW OF ATMOS' OPERATIONS**

2 **Q. CAN YOU PROVIDE THE COMMISSION WITH A GENERAL**  
3 **DESCRIPTION AND BACKGROUND OF ATMOS' NATURAL GAS**  
4 **DISTRIBUTION BUSINESS IN THE UNITED STATES?**

5 A. Yes. Atmos is the largest pure natural gas distribution company in the United States.  
6 Atmos delivers natural gas to approximately 3.1 million residential, commercial,  
7 industrial and public-authority customers in twelve states. Atmos has six  
8 unincorporated gas utility operating divisions. They are located in Denver, Colorado  
9 (Colorado/Kansas division); Dallas, Texas (Mid-Tex division); Baton Rouge,  
10 Louisiana (Louisiana division); Franklin, Tennessee and Owensboro, Kentucky  
11 (Kentucky/Mid-States division); Jackson, Mississippi (Mississippi division); and  
12 Lubbock, Texas (West Texas division). In addition, Atmos has an unincorporated  
13 operating division, Atmos Pipeline Texas, which is based in Dallas and consists of an  
14 intrastate pipeline that operates only in Texas.

15 Atmos' history dates back to 1906 in the Panhandle of Texas. Over the years,  
16 through various business combinations and mergers, the company became part of  
17 Pioneer Corporation, a large diversified West Texas energy company. In 1983,  
18 Energas, the natural gas distribution division of Pioneer, was spun off and became an  
19 independent, publicly held natural gas distribution company. In October 1988,  
20 Energas changed its corporate name to Atmos Energy Corporation and began trading  
21 on the New York Stock Exchange.

22 Since 1986, Atmos has completed several significant acquisitions. In 1986,  
23 Atmos expanded its natural gas distribution business to Louisiana with the acquisition

1 of Trans Louisiana Gas Company. In 1987, Atmos further expanded its operations  
2 into Kentucky with the acquisition of Western Kentucky Gas Company. In 1993,  
3 Atmos acquired Greeley's Kansas and Colorado operations and in 1997 it acquired  
4 United Cities Gas Company, which operated in eight states including Kansas. Both  
5 of these transactions were approved by the Commission. In 2000, Atmos acquired  
6 the Missouri assets of Arkansas Western Gas Company. In 2001, Atmos completed  
7 its purchase of the assets of Louisiana Gas Service Company and LGS Natural Gas  
8 Company. In December of 2002, Atmos expanded its operations into Mississippi  
9 with the acquisition of Mississippi Valley Gas Company. Most recently, in 2004,  
10 Atmos acquired the natural gas and pipeline operations of TXU Gas Company from  
11 TXU Corp. The operations acquired in this transaction consist of what is now  
12 Atmos' Mid-Tex division and Atmos Pipeline-Texas.

13 Atmos' corporate offices are located in Dallas, Texas, and provide services  
14 such as accounting, legal, human resources, purchasing and information technology  
15 and customer support centers located in Amarillo and Waco, Texas. These  
16 centralized services, commonly referred to as Shared Services, are shared with the  
17 other divisions in order to avoid having to staff and maintain these functions at each  
18 division level. They are the technical and administrative services that would be  
19 required if the division was a stand alone company today. Atmos believes that this  
20 structure gives it an economic advantage and helps it be a low cost, high quality  
21 service provider.

1 **Q. CAN YOU PROVIDE THE COMMISSION WITH A GENERAL**  
2 **DESCRIPTION AND BACKGROUND OF ATMOS' OPERATIONS IN**  
3 **KANSAS?**

4 A. Yes. Atmos' Colorado/Kansas division provides natural gas service to over 239,000  
5 customers in 177 communities located in Colorado, Kansas and Missouri. Our  
6 division office is located in Denver, Colorado. Our regional offices are located in  
7 Greeley, Colorado and Olathe, Kansas.

8 Atmos serves over 123,750 customers in Kansas. Atmos acquired about  
9 30,000 of its Kansas customers when it acquired Greeley in 1993 and 80,000  
10 customers when it acquired United Cities Gas Company in 1997 and the remainder  
11 have come through growth since the two purchases. Greeley had acquired its  
12 customers in Kansas over the years by acquiring smaller rural gas distribution  
13 companies spread throughout the state. United Cities Gas Company had acquired its  
14 customers in Kansas when it acquired the Union Gas System in the late 1980s.  
15 Atmos serves 106 communities in Kansas. The communities are spread throughout  
16 the state, and include Olathe, Bonner Springs, DeSoto and portions of Kansas City,  
17 Overland Park, Shawnee, Lenexa and Lawrence in the Kansas City metropolitan area,  
18 Independence, Coffeyville and Yates Center in Southeast Kansas, Council Grove and  
19 Herington in Central Kansas, Anthony and South Haven, near Wichita, Ness City in  
20 Northwest Kansas and Ulysses and Johnson City in Southwest Kansas, just to name a  
21 few.

22 Our customer base consists of approximately 113,500 residential customers,  
23 9,700 commercial customers, 72 industrial customers, 239 irrigation customers, and

1 239 transportation customers. We have a Kansas-based work force of approximately  
2 146 employees. Our utility plant includes 3,700 miles of service lines, distribution  
3 and transmission lines. I have included a map of Atmos' Kansas service territory as  
4 Exhibit GLS-1.

5 **IV. FACTORS REQUIRING ATMOS TO FILE THIS RATE APPLICATION**

6 **Q. WHAT ARE THE PRINCIPAL FACTORS REQUIRING ATMOS TO FILE**  
7 **THIS RATE APPLICATION?**

8 A. Atmos is seeking approval of a rate increase of approximately \$5.0 million. The  
9 increase to the bill of an average residential customer would be approximately \$3.90  
10 per month. Although Atmos operates very efficiently, we are not receiving a fair  
11 return on our investment with the rates currently in effect. The proposed increase will  
12 allow Atmos to establish new rates that will provide a fair return in order to attract the  
13 capital needed to make the necessary additions, replacements and improvements to  
14 our distribution system in Kansas.

15 While Atmos makes every effort to control expenses, a portion of the  
16 requested increase is necessary to cover increased costs for items such as salary and  
17 wage increases, increased medical costs and higher pension benefits. At the same  
18 time, steady declines in customer usage caused by energy conservation, more  
19 efficient homes and appliances and changes in lifestyles continue to erode our  
20 margins. We simply cannot continue to absorb these higher costs given the current  
21 level of our investment while margins continue to decline due to the reduction in  
22 customer usage.

1 **Q. WHEN WAS THE COMPANY'S LAST GENERAL RATE PROCEEDING IN**  
2 **KANSAS?**

3 A. The Company's last rate proceeding concluded in 2004 with an increase to  
4 Company's rates of \$2.5 million.

5 **Q. WHAT RATE OF RETURN ON RATE BASE IS ATMOS REQUESTING IN**  
6 **THIS RATE APPLICATION?**

7 A. Atmos is asking the Commission to approve new rate schedules that would increase  
8 revenues to provide an overall rate of return on rate base of 8.47% on the test year  
9 rate base of \$135,600,000.

10 **Q. IS ATMOS CURRENTLY EARNING A FAIR RETURN ON ITS KANSAS**  
11 **OPERATIONS?**

12 A. Atmos is not achieving a fair return under the current rates based upon the revenues  
13 generated during the test year (twelve months ending March 31, 2007) after those  
14 revenues and Atmos' expenses have been normalized and adjusted for known and  
15 measurable changes. Atmos' calculated rate of return on rate base is 6.26%.

16 **Q. WHAT IS THE RATE OF RETURN ON COMMON EQUITY AND RATE OF**  
17 **RETURN ON RATE BASE REQUESTED IN THIS RATE APPLICATION?**

18 A. The requested rate of return on common equity in this case is 11%. The requested  
19 rate of return on rate base is 8.47%. Dr. Bruce Fairchild will testify to the requested  
20 rate of return.

21 **V. CUSTOMER UTILIZATION ADJUSTMENT**

22 **Q. PLEASE DISCUSS THE PROPOSED CUSTOMER UTILIZATION**  
23 **ADJUSTMENT (CUA).**

1 A. As the Commission is aware, the WNA approved in Docket 03-ATMG-539-TAR,  
2 addresses variances in the recovery of revenues resulting from deviations from  
3 normal weather. While both the company and its customers benefit from this  
4 mechanism, there is a fundamental issue that the current WNA does not address. The  
5 existing tariff rider does not consider variables that impact customer usage other than  
6 weather, such as the increasing energy-efficiency of appliances, more efficient new  
7 homes, and conservation. Energy conservation has become increasingly important as  
8 utilities, their customers, as well as local, state and federal government agencies, seek  
9 to find ways to place downward pressure on natural gas prices and make efforts to  
10 ensure adequate energy supplies to meet the needs of future generations of  
11 Americans. The state of Kansas under the leadership of its Governor has correctly  
12 made energy efficiency a top priority. However, under traditional rate design a utility  
13 typically recovers its cost of service through a monthly customer charge and a  
14 volumetric charge. A large portion of the utility's fixed costs, which are costs that are  
15 incurred by the utility regardless of how much natural gas is used by its customers, is  
16 recovered through the volumetric charge. In other words, in order to recover all of  
17 the fixed costs approved by the Commission, Atmos must sell a certain amount of  
18 natural gas to its customers. This type of rate structure dictates a need for continued  
19 growth in sales volumes in order to recover fixed costs and authorized revenue  
20 requirement. In the current environment, this acts as a built-in disincentive for local  
21 distribution companies to encourage conservation, and thereby falls short of aligning  
22 the interests of utilities and their customers on this important issue. The proposed  
23 CUA will compliment the existing WNA and will eliminate the disincentive that is



1 included in the current rate design, which makes it difficult for the utility to  
2 encourage energy efficiency. The CUA will allow utilities to actively promote  
3 energy efficiency because the CUA will adjust the actual non-gas revenues to the  
4 level established in this docket. Therefore, if Atmos and this Commission implement  
5 energy efficiency programs for Atmos' utility customers which result in lower sales  
6 volumes for Atmos, adoption of the CUA will mean that Atmos will not be penalized  
7 for its efforts to promote energy efficiency. Since the revised mechanism will  
8 decouple Atmos' revenues from the volume of gas consumed, the disincentive that  
9 currently exists for Atmos to encourage energy efficiency and conservation would be  
10 eliminated.

11 Atmos witness Gary Smith addresses the proposed CUA in depth in his  
12 testimony.

13 **Q. DOES A CUA GUARANTEE THE COMPANY WILL EARN ITS**  
14 **AUTHORIZED RATE OF RETURN?**

15 A. No. The CUA only adjusts to the authorized revenue established by the Commission  
16 and adjusts for customer growth. It does not adjust for changes in operations and  
17 maintenance expense or increased investment in our distribution system.

18 **Q. ARE THERE OTHER CHANGES TO EXISTING TARIFFS OR**  
19 **ADDITIONAL TARIFFS REQUESTED IN THIS PROCEEDING?**

20 A. Yes. Mike DeArmond, Vice-President of our Kansas operations will discuss several  
21 updates and changes to our tariffs. These changes are designed to better align our  
22 tariff with billing standards, and modify transportation terms & conditions to reflect  
23 current business operations.

1 **Q. HAVE THERE BEEN ANY CHANGES TO THE COMPANY'S APPROACH**  
2 **TO DELIVERING CUSTOMER SERVICE SINCE THE CONCLUSION OF**  
3 **DOCKET NO. 03-ATMG-1036-RTS?**

4 A. Yes. The company has evaluated its processes and technologies as they relate to all  
5 aspects of how we serve our customers and on June 11, 2007 announced the  
6 formation of a new customer service organization. The creation of this organization  
7 will put all customer service functions under one management structure and thereby  
8 enable the Company to deliver customer service in the most efficient manner  
9 possible. It will result in the consolidation of the Customer Support Centers, the  
10 customer dispatch function, all revenue and management functions including billing,  
11 payment and collections, measurement and feedback as well as quality assurance into  
12 a single organization. This will allow us to build on all of the recent enhancements to  
13 our customer service the Company has made in recent years and fully integrate them  
14 into one organization whose singular focus will be delivering superior customer  
15 service.

16 **VI. WEATHER NORMALIZATION ADJUSTMENT**

17 **Q. PLEASE DISCUSS THE CHANGES PROPOSED BY THE COMPANY IN**  
18 **THIS PROCEEDING TO ITS WEATHER NORMALIZATION**  
19 **ADJUSTMENT.**

20 A. The Company has had a WNA mechanism in place in Kansas since 2002. Basically,  
21 the WNA is a method of adjusting portions of customer billings back to "normal"  
22 weather. This adjustment lessens the effects of unusually warm or cold winter  
23 weather patterns on both the customers and the Company. In this rate proceeding, the

1 Company proposes to update both the heat load and base load factors that are utilized  
2 in calculating WNA adjustments prospectively. These factors have not been updated  
3 since 2002. Mr. James Cagle discusses the changes to the Company's WNA tariff in  
4 his testimony.

5 **VII. AMI AND GSRS TARIFFS**

6 **Q. PLEASE DISCUSS THE ADVANCED METERING INFRASTRUCTURE**  
7 **TARIFF PROPOSED BY THE COMPANY.**

8 A. The Company proposes to implement a new tariff that would allow it to begin earning  
9 a return more quickly on new capital investment in Kansas relating to the Company's  
10 AMI program. AMI is a fixed based automated meter reading (AMR) network that  
11 will eliminate the necessity of manual meter reading because it essentially provides  
12 "real-time" consumption data that is electronically transmitted from a customer's gas  
13 meter to the Company's customer information system. AMI presents a number of  
14 advantages including:

- 15 ● Facilitating energy efficiency
- 16 ● "Real-time" meter reading
- 17 ● Elimination of human error
- 18 ● Elimination of "read and run" and re-read orders
- 19 ● Reduced operating and maintenance (O&M) expense
- 20 ● Enhancement of customer safety
- 21 ● Early detection of meter measurement problems
- 22 ● Elimination of most customer premise accessibility issues
- 23 ● Reduction in potential for damage claims and lost-time incidents

1                   •       Reduction in theft of service

2                   The AMI technology will facilitate energy efficiency for both the customer and the  
3                   Company. AMI will enable a customer to more closely monitor consumption and to  
4                   make energy consumption choices or changes based upon information available to  
5                   him or her. AMI will enhance the Company's abilities in forecasting gas supply  
6                   requirements of customers for as well as delivering the gas to the customers.

7                   The Company's AMI tariff will work similar to a Gas System Safety and Reliability  
8                   ("GSRs") tariff by allowing the Company to include the new infrastructure as part of  
9                   its invested capital for rate purposes in between general rate cases. Investment  
10                  amounts included in the tariff will be subject to full review in a subsequent rate case  
11                  and revenues collected pursuant to the tariff would be subject to refund. AMI,  
12                  together with the energy efficiency benefits that will be derived by the Company's  
13                  customers from that technology, is addressed in the testimonies of Mr. David Anglin  
14                  and Mr. DeArmond.

15   **Q.       PLEASE DESCRIBE THE GSRs TARIFF PROPOSED BY THE COMPANY.**

16   A.       In its 2006 session, the Kansas Legislature enacted Senate Bill No. 414 known as the  
17              Gas Safety and Reliability Policy Act. The legislation authorizes gas utilities to,  
18              subject to Commission approval and oversight, implement a surcharge to recover  
19              costs associated with mains, valves, service lines, regulator stations, etc. that are  
20              installed to comply with state or federal safety requirements as replacements for  
21              existing facilities, main relining and other projects that extend the useful life or  
22              enhancing the integrity of pipeline system components undertaken to comply with  
23              state or federal safety requirements, or non-reimbursed relocations required due to

1 road construction or improvements by a federal, state or local governmental authority.  
2 The Company's GSRS tariff is proposed in connection with this recent legislation to  
3 address costs incurred by the Company related to natural gas utility plant projects  
4 covered by the act.

5 **VIII. INTRODUCTION OF WITNESSES**

6 **Q. PLEASE INTRODUCE THE OTHER WITNESSES SPONSORING**  
7 **TESTIMONY IN THIS PROCEEDING AND BRIEFLY SUMMARIZE THEIR**  
8 **TESTIMONY.**

9 A. In addition to my testimony, Atmos will present the direct testimony and exhibits of  
10 nine witnesses.

11 Mr. James C. Cagle, Manager of Rates and Revenue Requirements, Atmos  
12 Energy Corporation, Dallas, Texas addresses rate base items, revenues and expenses,  
13 common cost allocations and updates the WNA factors;

14 Mr. Thomas H. Peterson, Director of Rates, Atmos Energy Corporation,  
15 Dallas Texas, sponsors the class cost of service study that was used to develop the  
16 proposed new rates. Mr. Peterson also sponsors Atmos' cash working capital  
17 calculation;

18 Mr. Donald S. Roff, President, Depreciation Specialty Resources sponsors a  
19 depreciation study for our Kansas assets and our common assets;

20 Dr. Bruce Fairchild testifies regarding a reasonable cost of equity and the  
21 overall cost of capital to be used in setting rates for Atmos;

22 Mr. Daniel Meziere, Director of Accounting Services for Atmos, sponsors  
23 Atmos' books and records and Atmos' Cost Allocation Manual (CAM);

1 Ms. Laurie Sherwood, Atmos' Vice President Corporate Development and  
2 Treasurer testifies on the appropriate capital structure and cost of debt for the purpose  
3 of setting rates in this docket;

4 Mr. Gary Smith, Atmos' Director of Customer Revenue Management,  
5 provides testimony in support of Atmos' proposed Customer Utilization Adjustment  
6 ("CUA") and testimony in support of Atmos' proposed rates;

7 Mr. Mike DeArmond, Operations Vice President at the Colorado/Kansas  
8 Division, sponsors testimony relating to Atmos' Kansas operations, the AMI  
9 technology, the Company's proposal to implement a GSRS tariff and proposed  
10 changes to Atmos' Kansas tariffs; and

11 Mr. David Anglin, Atmos' Director of Utility Operations, sponsors testimony  
12 relating to the Company's AMI project.

13 **Q. DO YOU HAVE ANY CLOSING REMARKS?**

14 A. Yes. It is my opinion that the rates requested in this filing are just, reasonable, and in  
15 the public interest and would encourage the Commission to provide prompt and  
16 adequate rate relief.

17 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

18 A. Yes.

**VERIFICATION**

STATE OF COLORADO            )  
  ) ss.  
COUNTY OF DENVER            )

GARY L. SCHLESSMAN, being duly sworn upon his oath, deposes and states that he is President of Atmos' Kansas and Colorado operations; that he has read and is familiar with the foregoing Direct Testimony filed herewith; and that the statements made therein are true to the best of his knowledge, information, and belief.

\_\_\_\_\_  
GARY L. SCHLESSMAN

Subscribed and sworn to before me this \_\_\_ day of September 2007.

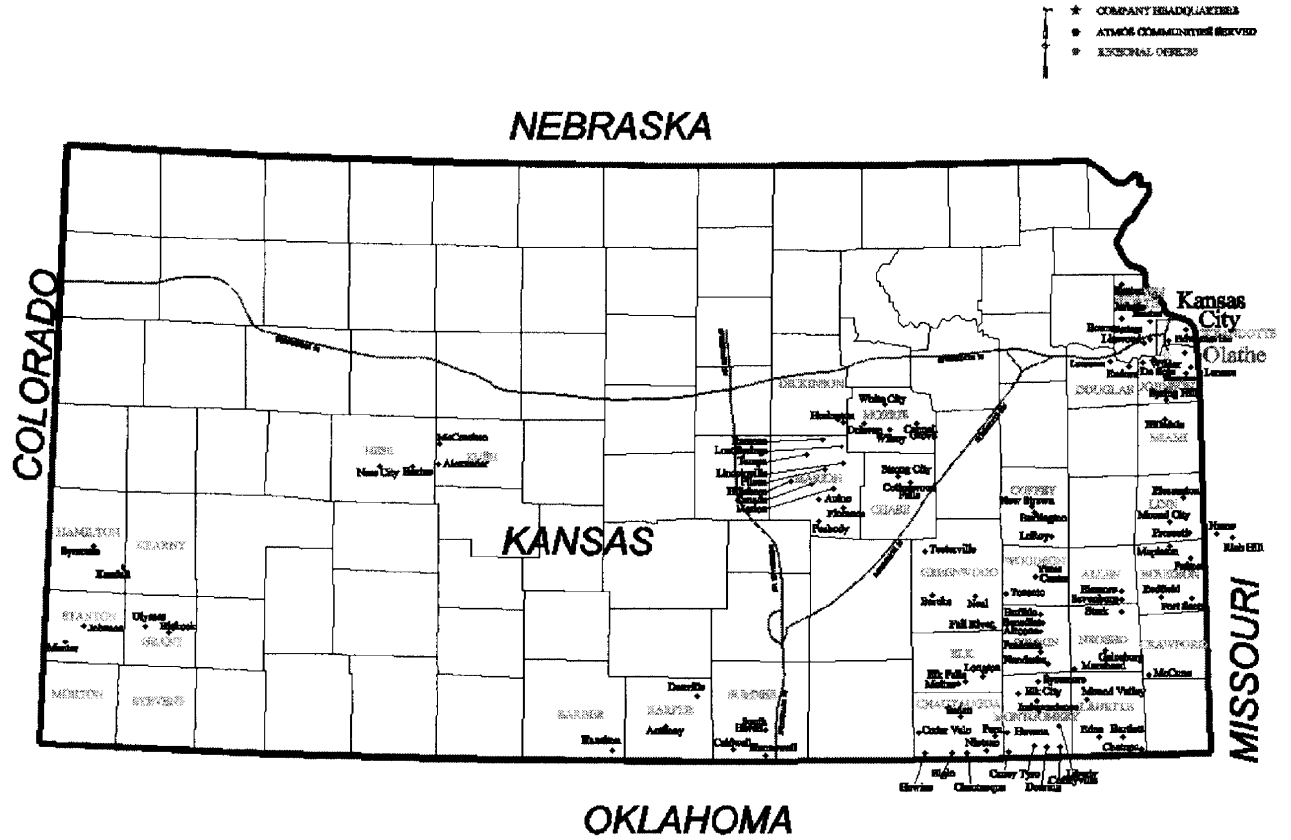
\_\_\_\_\_  
NOTARY PUBLIC

My appointment Expires:  
\_\_\_\_\_

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Exhibit GLS-1

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