THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

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 Natural Gas Rates in the State of Kansas	)))	Docket No. 08-ATMG-280-RTS

CURB's Reply to the Responses of Staff and Atmos

to CURB's Petition for Reconsideration

The Citizens' Utility Ratepayer Board (CURB) replies below to the responses of the Staff of the Kansas Corporation Commission and of Atmos Energy to CURB's Petition for Reconsideration, filed in the above-captioned docket on May 27, 2008. Staff's response was filed June 6, 2008; Atmos' response was filed June 9, 2008.

I. The settlement is not in "substantial compliance" with K.S.A. 66-2204.

1. In considering Staff's argument (Section C of its response) that the Commission is in substantial compliance with K.S.A. 66-2204 by approving the settlement agreement's provision that Atmos' GSRS rate shall be based on the average GSRS rates of other utilities, one must first look to the purpose of the statute. As Staff noted, an agency is in "substantial compliance" when its order complies "in respect to the essential matters necessary to assure every reasonable objective of the statute." *City of Lenexa v. City of Olathe*, 233 Kan. 159, 164 (1983).

2. K.S.A. 66-2204 is one of four statutes that make up the Gas Safety and Reliability

Policy Act, K.S.A. 66-2201 *et seq.* (The Act). The objective of the statute, is clear: it is intended to provide a natural gas utility recovery on its expenditures for safety and reliability between rate cases at a rate of return that is commensurate with the utility's embedded rate of return. The Act's entire set of provisions is designed to make sure that the GSRS enables the utility to recover no more and no less than it would if the costs were embedded in base rates. To ensure that the GSRS rate is commensurate with the utility's embedded rate of return, K.S.A. 66-2204 first prescribes a formula for determining the GSRS rate that is virtually identical to that used by the Commission in rate cases to determine the utility's overall rate of return to embed in base rates. Thus, the Act is founded on the logical assumption that the Commission will utilize the readily-available information about the company in its rate case to determine the GSRS rate when the application for approval of a GSRS rate is made as part of a company's rate case application.

3. The Act then provides an alternative method for determining the GSRS rate in circumstances where timely, detailed information is not available about the company and the parties have not reached agreement about the appropriate GSRS rate. This is clearly a fallback provision for use only outside the context of a rate case: detailed information is always available in a rate case, because statutes and KCC regulations demand it. This provision enables the Commission to approve an appropriate GSRS rate for a company that does not have the need at the present time to file a general rate application.

4. However, the time limits on the GSRS make it clear that the intent of the Act is to ensure that the GSRS rate mirrors the utility's embedded rate of return as closely as possible. The limits apply whether the GSRS application was made in conjunction with a rate case or not.

The Act requires the utility applying for a GSRS to have had a rate case within the past 60 months, unless the company is applying for the GSRS as a part of a current rate proceeding or has a current rate proceeding already underway. Further, the company may not collect a GSRS for a period longer than 60 months; it must file a new rate case. These time limits can have no other purpose than to ensure that the information used to set the GSRS rate is accurate and timely, which ensures that the GSRS rate initially accurately reflects the company's overall rate of return, and will continue to do so over time.

5. With each subsequent rate case, the costs approved for inclusion in the GSRS will then be embedded in base rates as a part of the rate case, after review for prudence and reasonableness. If the Commission disallows costs previously included in the GSRS, the utility must offset its future GSRS to recognize and account for such overcollections. This provision, too, ensures that cost recovery through the GSRS accurately mirrors the recovery the company would be allowed if these costs were recovered solely through base rates.

6. Looking back to the original purpose of the Act, which is to provide a return on safety and reliability expenses between rate cases that is commensurate with the company's embedded rate of return, it is clear that the methods provided in the Act for determining the GSRS rate are designed to further that purpose. The rate is set in a manner almost identical to that utilized to set the company's overall rate of return in a rate case. The duration of the surcharge is limited, to ensure thorough review of the costs included in the GSRS on a regular basis and to readjust the rate on the basis of current data. The Act includes a provision that mandates adjustments to the rate to remove disallowed costs.

7. It must be noted that, in providing an alternative method in K.S.A. 66-2204(9) for

determining the GSRS rate outside of a rate case, the legislature made no reference whatsoever to utilizing information about other utilities to set the rate. The Act remains focused, even in providing an the alternative method to set the rate, on establishing, to the extent possible, a GSRS rate that reflects that particular utility's overall rate of return. One presumes that the legislature recognized that when recent information is not available, and all the parties are able to come to an agreement on an appropriate GSRS return for the company that the Commission is willing to approve, that the consensus view will at least come close to reflecting an appropriate overall rate of return—or at least will not prompt litigation alleging that it does not. It is not a perfectly accurate method of ensuring that the GSRS rate tracks the embedded rate of return, but in the absence of the information required for an accurate determination, and with the time limits ensuring that any inaccuracy will not be perpetuated for more than 60 months, setting the rate on the basis of a consensus view suffices as an adequate substitute for the more accurate method of using the information that is available during a rate case, and enables a company not yet needing to file for a general rate increase to obtain approval of a GSRS.

8. When one looks at the Act as a whole, rather than in the piecemeal fashion promoted by Atmos and Staff, one cannot escape the conclusion that it is simply contrary to the purpose and objectives of the Act to ignore the available data about Atmos that was presented in this case, in favor of setting the GSRS rate by averaging the GSRS rates of other utilities. It goes without saying that setting the GSRS rate for one utility with reference to the rates of other utilities is not an alternative method expressly or implicitly provided by the Act. When the record contains a wealth of information from which the Commission may make an informed determination on Atmos' cost of equity based on fact and expert opinion specifically concerning

Atmos, using the rates of other utilities to set the GSRS rate of return veers significantly away from "every reasonable objective of the statute." 233 Kan. 164. Thus, "substantial compliance" with the purpose and spirit of the Act cannot be argued here. Substantial compliance with the Act would require following the procedures provided in K.S.A. 66-2204, which are clearly intended within the context of the Act to be used when the application for a GSRS rate is made in conjunction with a rate proceeding, to ensure that the GSRS rate is commensurate with the rate of return embedded in Atmos' rates.

9. Staff's argument that the Commission is in "substantial compliance" with section (9) of K.S.A. 66-2204 is not an argument that is available to the Commission in these circumstances, because section (9) provides an alternative method to use when the application for a GSRS is made outside the context of a rate case. Contrary to the company's assertion that section (9) of K.S.A. 66-2204 "is included in the statute to address those situations, where, as in this case, the rates are based upon a Commission-approved black-box settlement" (Atmos Response, at ¶22), nothing in the definitions section of the Act (K.S.A. 66-2202), or any other provision, refers to a black-box settlement—or a settlement of any sort—and there is nothing in the statute that defines or explains what the words "agreed-upon basis" mean. The plain meaning of the term "agreed-upon basis" lends itself more readily to an interpretation that this provision refers to an unanimous agreement more so than it does an interpretation that a contested settlement may satisfy the condition. Frankly, Staff's suggestion that "the statute is not particularly clear" (Staff Response, at ¶19) on this point is more nearly the case. However, the more logical interpretation, in the context of the Act as a whole, is that the alternative method provided in K.S.A. 66-2204(9) is intended to be used only when the wealth of information that is

generated in a rate case is not available to the Commission.

10. Obviously, Staff and Atmos argue that the phrase "agreed-upon basis" in section (9) allows the Commission to approve their agreement that would base the GSRS rate on the rates of other utilities. As noted above, the concept of agreement generally implies agreement among all the parties, not just some of them, in absence of specification otherwise. Furthermore, the argument ignores the legal and syntactical significance of the use of the word "and" in the beginning sentence of K.S.A. 66-2204(9): "in the event information pursuant to paragraphs (5), (6) and (7) are unavailable **and** the commission is not provided with such information on an agreed-upon basis, the commission shall utilize....." the alternative method outlined therein. Atmos reads the statute as if the first clause and the second clause were independent of each other, that the Commission may bypass the primary method of determining the GSRS set forth in earlier sections of the statute (1) when the information is not available, or (2) when the Commission is provided the information on an agreed-upon basis. But that's not what the statute says.

11. One must presume this clause was provided in case the initial GSRS filing was made outside the context of a rate case, when accurate, timely information would not be available, not, as Atmos contends, in the context of a rate case where the information is available, but is resolved by a settlement that is "agreed upon" by some of the parties. But a contested settlement can hardly be called "agreed upon." Even if a contested settlement can be said to be an agreement that satisfies the condition set forth in the second clause of section (9), the circumstances here do not satisfy the condition set forth in the first clause—that the information necessary to determine the rate is not available. The most straightforward interpretation of this

clause is that the Commission shall make the determinations outlined in K.S.A. 66-2204(5), (6) and (7) when the information is available—as it is when the application for the GSRS is made during the course of a rate case; and if the information is not available AND the parties have not reached an agreement on an appropriate rate, the Commission may use the alternative method outlined in section (9).

12. Arguments about whether the Commission is in "substantial compliance" with section (9) ignore completely the fact that there is no need to resort to section (9) at all when the GSRS application is made as a part of the company's general rate increase application. No one in this case is arguing that the Commission should use the alternative method outlined in section (9) at all. The Commission could completely avoid the difficulty of interpreting any perceived ambiguities in section (9) by simply following the procedure provided for setting a GSRS rate as a part of a rate case in K.S.A. 66-2204's earlier sections. Then the question of whether section (9) requires a lack of information AND unanimous agreement would be irrelevant, because the Commission would be in full compliance with the main body of the statute. Section (9)'s ambiguities would remain ambiguous, to be interpreted in some other case.

II. "Probably legal" is not legal.

13. It was surprising to see both the company and Staff rely on CURB's assertion during the hearing that the settlement was "probably legal," because CURB's opinions are not considered legal authority. Unfortunately, CURB's assertion that the settlement was "probably legal" failed to take into account the specific requirements of K.S.A. 66-2204. However, the Commission, in declining to determine a rate of return on equity for Atmos as CURB had

requested, nonetheless failed to comply with K.S.A. 66-2204. It is the Commission's responsibility, not CURB's, to make the ultimate determination of whether approving a settlement complies with the applicable laws. While CURB focused its concerns on the necessity of determining the return on equity for Atmos because it has been so long since the Commission has done so for a gas utility, and expressed its concern that determining the GSRS return on the basis of returns of other utilities would result in a GSRS rate that is unreasonably high, the Commission must focus its concerns on meeting the requirements of all applicable statutes in making its determinations. CURB may have erred in opining that the settlement was "probably legal," but the Commission was responsible for ensuring that it was indeed legal in every way. CURB's error does not excuse the Commission from that responsibility.

14. Furthermore, if the Commission had determined the return on equity as CURB requested, the Commission would have been in full, substantial compliance with K.S.A. 66-2204 because the other determinations required by K.S.A. 66-2204 were uncontested. As Staff noted, the cost of debt and capital structure that were set forth in the evidence of the case and in the settlement itself were uncontested. As the company noted, the company has no preferred stock, so that cost did not need to be determined. If the Commission had simply determined the return on equity for Atmos, and utilized it along with the uncontested cost of debt and capital structure to calculate the GSRS rate as provided in K.S.A. 66-2204, and voided only the settlement provision setting the GSRS rate by averaging the GSRS rate of other utilities, the Commission would have substantially complied with the statute.

15. Staff and the company also cite CURB's acquiescence to similar terms concerning the GSRS in previous settlements, as if CURB's signature on a settlement deprives CURB of the

right to point out that it now understands that the term is illegal. The fact is that several companies, members of Staff, CURB and the members of the Commission itself have repeatedly failed to observe the dictates of the Act. But it is solely the Commission's responsibility to apply it correctly. Previous failures in other dockets to apply the provisions of the Act correctly cannot possibly provide justification for perpetuating the error in this case, once the error has been identified. A rate illegally determined cannot be the basis of just and reasonable rates, which the Commission has the statutory responsibility to ensure. If the Act was also violated in another case, or in any other case determining a GSRS rate, then the Commission has the responsibility to investigate and correct the errors that have been made.

III. The "actual" cost of equity is what the Commission says it is.

16. Atmos also argues that the Act does not require the "actual" cost of equity to be used to calculate the GSRS rate. Atmos fails to acknowledge, however, that the requirement of the Act that the Commission determine the cost of equity "during the most recent general rate proceeding" is how "actual" costs of equity are determined. **The Commission's determination in a rate case of the cost of equity of a company IS the "actual" cost.** Unlike the "actual" cost of debt of a utility, which is a *retrospective* and *objective* determination that can easily be made by averaging the interest rates on the company's debt instruments on an allocated basis during the test year, the cost of equity is a *prospective* and *subjective* determination. It is a forward-looking estimate, based on historical evidence, future projections and expert opinions, of the level of return that the company must offer to attract a sufficient amount of investor capital on a going-forward basis. While the determining the cost of debt is rarely controversial, the appropriate

return on equity is often hotly contested. Although the parties' opinions may differ on what the appropriate level is, ultimately, the Commission's opinion is the only one that counts: **the company's cost of equity is what the Commission says it is**. If the Commission doesn't say, we don't know what it is.

17. K.S.A. 66-2204 recognizes the fundamental difference in the costs of debt and equity by omitting the word "actual" in referring to the cost of equity. However, the Act clearly contemplates that the return on GSRS costs would be calculated using the Commission's determination of the company's overall cost of capital and its actual cost of debt when the GSRS application is made in conjunction with the company's rate application, because these determinations are routinely made in a rate case. There is nothing in the Act's provisions that indicates that it is acceptable to use the rates of other utilities as the basis for the GSRS rate, simply because a couple of the parties agree to do it that way.

18. To resolve this problem of failure to comply with K.S.A. 66-2204, all the Commission has to do is look at the evidence provided in the rate case by the company, the Staff, and CURB in their prefiled testimony and in the evidentiary hearing, and determine the information required by sections (5), (6) and (7); these determinations form the basis for setting the GSRS rate. The company's GSRS rate can then be accurately calculated, as the Act intended it to be. The Commission can simply substitute this calculation for the provision in the settlement that sets the rate with reference to the rates of other utilities' GSRS rates. If, on reconsideration, the Commission does that, there will no need whatsoever to attempt to resolve the ambiguities of section (9) of K.S.A. 66-2204 and no need to determine whether the settlement agreement can be approved on the basis that it complies with section (9). When the Commission

reviews the Act with its essential purpose and objectives in mind, it can come to no other conclusion than it should make the determinations on the basis of evidence in the record, rather than accepting the terms of the settlement on this particular issue.

IV. Atmos's arguments against the Commission recording a regulatory liability for removals are without basis.

19. Atmos's arguments against ordering a regulatory liability on costs collected for future removals that the company has no legal obligation to carry out are simply unsupported by the record. The company argues that there is no basis for CURB's concern, although CURB cited Mr. Majoros' testimony about why ratepayers should be protected, and the Commission adopted his rationale in the Westar case. Atmos argues that Westar, which has been ordered to record a regulatory liability on removals of steam plant, is an electric utility and because Atmos is a gas utility, their circumstances are "significantly different." (Atmos Response, at ¶8). What Atmos fails to recognize is that its not the utilities' circumstances that are of concern: it's the ratepayers' circumstances. Any amount recovered by a utility for future removals at risk of not being spent for its intended purpose, which is an argument that the Commission has already accepted as fact in the previous Westar case. Whether the removals are of steam plant, or of gas mains, or of any "specific asset," the concern is not the nature of the removals themselves: it is the fact that the company collects a lot of money from ratepayers that isn't actually spent for its intended purpose for a long time—if ever, and things can change over time. Mr. Majoros' testimony was uncontested that the telephone companies took $11 billion of ratepayer contributions for removals into income when the regulatory regime changed. Like Atmos, the

telephone industry doesn't have major generating plants like Westar, either, but has lots of buildings and distribution infrastructure—much like a gas utility—and the money ratepayers spent for removals was instead credited to income. Although Atmos is correct to state that there are no known changes pending for the natural gas industry, it could happen: regulations change.

20. No one has accused Atmos of not removing assets over time. The point of recording a regulatory liability is simply to protect ratepayers if the money collected for removals isn't spent for removals. Further, Atmos cannot possibly suffer harm in the financial community if the Commission protects the ratepayers, and Atmos cites no authority for that proposition. In fact, the regulatory liability has been reported by Atmos in its SEC financial statements and reports and in GAAP financial statements since 2003, so the financial community has been well aware of the liability for several years. CURB simply wants stable protection for ratepayers from the *regulatory* community, which has been known to change philosophy and direction from time to time.

21. The notion that regular rate cases will protect ratepayers is absurd. Regulators' scrutiny during periodic telephone rate cases did nothing to protect telephone customers when the federal regulatory regime was changed. It won't protect Atmos' customers, either, if the Commission does not take the opportunity in a rate case to order the company to record a regulatory liability. Additionally, Atmos argues that CURB is wrong in asserting that recording a regulatory liability will not cost the utility, but cites nothing in the record as support for that statement.

22. Finally, to the extent that CURB made arguments for recording a regulatory liability in its Petition for Reconsideration that are not repeated herein, CURB does not abandon

these arguments, but stands by them, as if set forth herein.

Respectfully submitted,

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VERIFICATION

STATE OF KANSAS)
) ss:
COUNTY OF SHAWNEE)

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

That she is an attorney for the above named petitioner; 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 19th day of June, 2008.

Notary of Public

My Commission expires: 8-03-2009.

SHONDA D. TITSWORTH
Notary Public - State of Kansas
My Appt. Expires August 3, 2009

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 19th day of June, 2008, to the following:

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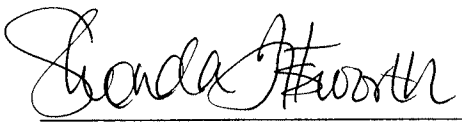

Shonda Titsworth

* Denotes those receiving the Confidential version