BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Atmos Energy Corporation's Tariff Revision Designed to Consolidate Rates and Implement a General Rate Increase for Natural Gas Service in the Missouri Service Area of the Company.	)))))	Case No. GR-2006-0387

BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL

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I. INTRODUCTION

On April 7, 2006, Atmos Energy Corporation ("Atmos" or "Company") filed proposed tariffs with the Missouri Public Service Commission ("Commission") designed to increase rates for its non-gas natural gas local distribution service to recover approximately $3.396 million in additional revenue. Staff's testimony concluded that Atmos is currently over-earning by approximately $1.2 million annually, yet Staff chose not to file a complaint against Atmos. Unfortunately, Atmos' current over-earning is not the most troubling issue in this case. Staff and Atmos want the Commission to make a radical change to decades of successful ratemaking principles pursuant to an understudied Staff analysis that fails to carefully consider the implications such a drastic change will have on Atmos' customers. If adopted, Staff's break from historic rate design will discourage efficiency and conservation, and will shift costs upon the shoulders of low use ratepayers. While the rest of the nation, including gas industry leadership, is promoting aggressive efficiency and conservation programs and policies, the Staff's proposal would decrease a consumer's ability to conserve with no offsetting benefits. There is no evidence in this case to demonstrate that the current rate design is insufficient, however,

there is evidence that the existing rate design has provided Atmos with more than a reasonable opportunity to earn its authorized revenue requirement. Claims that Atmos is somehow unable to recover its revenue requirement under the existing rate design lack any support in the record. This rate design issue, and the other remaining issues in this case are explored in greater detail below.

II. ARGUMENT

A. REVENUE REQUIREMENT

1. ISSUE: What is the appropriate rate of return/return on equity?

Public Counsel supports the Staff's recommended rate of return and return on equity if the Commission maintains the current rate design. If the Commission adopts a rate design proposal that eliminates weather variability and other business risk for Atmos, a corresponding reduction should apply to the return on equity. The United States Supreme Court, in *Bluefield Water Works and Improvement Company v. Public Service Commission of West Virginia,* 262 U.S. 679, 67 L.Ed. 1176, 43 S.Ct. 675 (1923), and in *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 88 L.Ed. 333, 64 S.Ct. 281 (1944), mandated that the rate of return for a utility must be comparable to the return on investments in other enterprises having a corresponding risk. In *Bluefield*, 262 U.S. at 692-93 (1923), the Supreme Court held:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures.

The rate design proposed by the Staff fails to properly apply the *Hope* and *Bluefield* analysis by not factoring risk into the calculation of return on equity. Under the Staff's proposal to eliminate earnings variability for Atmos, revenues anticipated to be collected "will be collected with virtual certainty." (Ex. 203, p. 6).[1] Unless the elimination in business risk is accounted for through an offsetting reduction in the Company's rate of return, customers will unjustly pay through rates the higher return associated with a riskier investment in violation of the *Hope* and *Bluefield* standards. (Ex. 203, p. 8).

Staff testified that the main business risk for Atmos is weather variability and removing such risk would make Atmos a less risky investment, however, this reduced business risk was not a criteria considered by Staff when it calculate its recommended return on equity. (Tr. 111-113). This is not surprising since the only risk consideration Staff made was whether the proxy companies are local distribution companies. (Tr. 113-114). Assuming all LDCs have identical risk fails to take into account the differences in risk resulting from different rate designs. It was only after the Staff performed their return on equity calculation that the Staff researched the rate designs approved for the Staff's group of proxy companies. (Tr. 117-118). Staff was unaware of the details of those rate designs, and was only aware of whether they offered some form of weather mitigating rate design. (Tr. 121, 126). The risk implications for *mitigating* weather variability and completely *eliminating* weather variability have obvious differences not recognized by the Staff's recommended return on equity. (Tr. 177). Staff proposes to completely eliminate weather variability through its rate design, yet the group of proxy companies continue to face the risk of weather variability and are not truly comparable. (Tr. 173, 177). There has been no analysis to determine whether the return on equity

[1] All references to Exhibits and Transcripts will be identified "Ex." and "Tr." respectively.

endorsed by the Staff equals a return for companies with corresponding risks and uncertainties as required by the Supreme Court in *Bluefield*.

Staff witness Mr. Steve Rackers acknowledged that an approval of Staff's rate design coupled with no changes to revenue would give Atmos a return on equity of "roughly" 12.0%. (Tr. 96). Mr. Trippensee performed the calculation and determined that approving the Staff's rate design with no changes to revenue would give Atmos a return on equity of 12.6%. (Tr. 180). This is well outside of the Staff's range of 8.5% to 9.3%, is above Atmos' proposed 12.0%, and is well above what should be approved for a company that will have no risk of weather variability. In the Missouri Gas Energy rate case that is currently pending before the Commission in Case No. GR-2006-0422, MGE's return on equity witness testified to the need for a downward adjustment to return on equity to reflect the reduction in risk associated with a revenue decoupling rate design. (Tr. 170). No such downward adjustment has been factored into the return on equity proposals of Staff or Atmos.

No methodology currently exists to factor reduced business risk into a return on equity calculation, and therefore, Mr. Trippensee developed a methodology that quantifies the impact that eliminating most business risk for Atmos should have on the Company's return on equity. (Tr. 168, 179-180). Mr. Trippensee's methodology used the Staff's facts and data, which Mr. Trippensee reviewed and found to be reliable, and determined that a return on equity that considers the business risk reduction should be more than the 6.03% cost of debt for Atmos. To determine how much more, Mr. Trippensee utilized the spread between the risk free rate of 5.13% and the 6.03% cost of long-term debt, to conclude that the return on equity approved for Atmos should be

0.87% more than the cost of debt, or 6.90% rounded to 7.0%. (Ex. 203, p. 11). Public Counsel's recommended return on equity protects ratepayers from a return on equity that is unjust and unreasonable by incorporating the correlating changes in risk associated with a utility whose earnings no longer depend on changes in weather and other earning risks. No party has offered an alternate methodology to factor the reduction in risk into the return on equity calculation.

a. Missouri Law Recognizes the Need to Adjust Return on Equity in Response to Corresponding Changes in Risk

In the Commission's decision approving a rate increase for Missouri Gas Energy in 2004, the Court of Appeals upheld the Commission's decision to increase "Staff's recommended return on equity in recognition of the higher risk to shareholders from the large amount of debt" in the capital structure. *State ex rel. Missouri Gas Energy v. PSC,* 186 S.W.3d 376 (Mo. App. W.D. 2005). Rate of return analysis under *Hope* and *Bluefield* should not be a one-way analysis – both increases and reductions in risk should be considered. Just as the Commission in MGE's last rate case recognized the need to increase the return on equity when risk increases, the Commission should reduce the return on equity for Atmos should the Commission adopt a rate design that significantly lowers business risk.

In *State ex rel. Missouri Water Company v. P.S.C.,* 308 S.W.2d 704 (Mo. 1957), the Supreme Court of Missouri held that "the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks." By essentially guaranteeing a specific return for Atmos, and by eliminating the majority of Atmos' business risk, the enterprises with corresponding risks should change.

Staff and Atmos have made no changes to account for this risk reduction, and their recommendations for return on equity are not commensurate with returns on investments in other enterprises having corresponding risks.

Missouri Senate Bill 179 acknowledges the need to reduce a natural gas utility's return on equity to account for the reduction in business risk associated with a weather mitigating rate design. In Section 386.266.7 RSMo (2005 Cum. Supp.), the Missouri Legislature added a provision to the statute allowing the Commission to approve weather normalization adjustments. That provision states:

> The commission may take into account any change in business risk to the corporation resulting from implementation of the adjustment mechanism in setting the corporation's allowed return in any rate proceeding, in addition to any other changes in business risk experienced by the corporation.

This demonstrates the Legislature's concern that reductions in a utility's business risk should be factored into the approved return.

b. Revenue Decoupling Analyses Have Included the Recognition of a Need to Reduce the Return on Equity

Recognizing the reduced return on equity that logically flows from a reduction in risk is not a novel concept and has been recognized by courts and other regulatory agencies. When the Federal Energy Regulatory Commission (FERC) restructured the interstate natural gas pipeline industry in 1992, it adopted a straight fixed variable (SFV) rate design in order to promote competition. The FERC recognized the impact of a SFV

rate design on risk in determining return on equity and concluded that such recognition should be considered in rate proceedings.[2]

Other states have also recognized the impact of eliminating risk. In a recent decision by the Iowa Utilities Board (IUB), the IUB concluded that the traditional rate design approach was "sufficiently flexible to allow for adjustments if circumstances unreasonably limit a utility's opportunity to earn its authorized rate of return." A "significant flaw" specifically mentioned by the IUB in the rate design proposal before it "was the absence of an adjustment to the return on equity to reflect the reduced risk that would accompany the approval of the" proposal. The IUB found no support for a return on equity that "did not reflect any consideration of what an appropriate return on equity should be for low-risk revenue recovery mechanisms…"[3]

The California Supreme Court upheld a decision of the California Public Utilities Commission (CPUC) that reduced a gas company's rate of return in light of the impact of an investment tax credit. The Court stated:

> While no witness testified that a rate of return reduction of .25 percent would exactly reflect the reduced business risk SoCal would enjoy as a result of the capital available from the tax credit, witnesses were repeatedly asked to quantify the financial impact of the tax credit. Most witnesses said the impact was difficult, if not impossible, to quantify…"

The Court found support for the CPUC decision to reduce the company's rate of return and upheld the CPUC decision. *Southern California Gas Co. v. PUC,* 592 P.2d 34 (Cal.

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[2] FERC Order No. 636, 57 FR 13267, *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol,* April 16, 1992.

[3] Iowa Utilities Board, *Final Order on Rehearing and Granting of Waiver,* Docket Nos. RPU-05-2 and WRU-06-16-225, *In re. Aquila, Inc. d/b/a Aquila Networks,* 2006 Iowa PUC LEXIS 394, September 12, 2006.

1979). This case highlights the difficulty in calculating an appropriate reduction in return and the need to rely on the best evidence available to make that determination.

The ***National Action Plan for Energy Efficiency***, attached to the Surrebuttal Testimony of Atmos witness Mr. Gary Smith, is a plan developed in July 2006 by more than fifty leaders of regulatory and industry organizations and facilitated by the U.S. Department of Energy and the U.S. Environmental Protection Agency. The Plan was co-chaired by Diane Munns, Iowa Utility Board Commissioner and President of NARUC, and Jim Rogers, President and CEO of Duke Energy. The Plan states:

> An effective decoupling plan should lower utility risk to some degree. Reduced risk should be reflected in the cost of capital and, for investor-owned utilities, can be realized through either an increase in the debt/equity ratio or a decrease in the return on equity investment. For all utilities, these changes will flow through to debt ratings and credit requirements. (Ex. 4, Schedule GLS-2, Appendix A-3)

The Plan also recognizes one of the consumer benefits associated with revenue decoupling is the lower risk for the utility, which "should lead to consumer benefits through an overall lower cost of capital to the utility." (Ex. 4, Schedule GLS-2, p. 2-4). Clearly the reduction in return on equity is not a novel concept and is recognized throughout the nation by regulatory and industry leaders alike.

In conclusion, the Staff and Atmos propose returns on equity that fail to consider the reduction in risk that should result from a rate design that eliminates a significant portion of Atmos' business risk. The proxy companies identified by the Staff do not have similar risks because they do not operate under rate designs where weather is not a factor. Where this issue has been considered elsewhere, the conclusion has been to reduce the company's return on equity to correspond to the reduction in risk. Mr. Trippensee

provides an analysis that factors this reduction in risk into the return on equity calculation that should be adopted if the Commission approves a revenue decoupling rate design.

2. ISSUE: What is the appropriate level of revenue excess/deficiency?

The Staff conducted a thorough analysis of Atmos' revenue needs and determined that Atmos is currently earning a revenue excess of approximately $1.2 million annually at the expense of Atmos' customers. (Ex. 104, p. 1-2). Staff calculated this revenue excess using a return on equity between 8.59% and 9.39% that did not take into account the reduction in risk associated with the Staff's rate design proposal. *Id*. Factoring in the reduced weather related risk lowers the appropriate return on equity to 7%, which would increase Atmos' revenue excess by approximately $600,000 annually. (Ex. 203, p. 11). Public Counsel believes the Commission should lower Atmos' revenues under the Commission's Section 393.140(5) RSMo 2000 authority to "determine and prescribe the just and reasonable rates and charges." At the very least, the Commission should instruct its Staff to file an over-earnings complaint against Atmos. The Staff believes its $1.2 million over-earning findings are reasonable and defendable. (Tr. 96).

B. DEPRECIATION

1. ISSUE: What is the appropriate treatment of depreciation and should depreciation expense be reduced by a depreciation reserve amortization?

Staff witness Mr. Guy Gilbert proposes that the Commission reduce the annual depreciation expense accrual by $591,000. Public Counsel opposes this proposal because it will require Atmos to *reinvest monies already paid by ratepayers* in order to reduce current rates, and will require the customers to *pay a return* "on and of" these amounts in future rates. (Ex. 203, p. 13). Ratepayers traditionally pay a return that rewards investors

and encourages future investments, and in this regard, requiring ratepayers to pay a return on investments is just and reasonable. In contrast, forcing ratepayers to pay a return on monies paid by the ratepayers themselves causes the ratepayer to needlessly pay a return that has no justification. Future ratepayers would then be forced to pay a return on these amounts taken from Accumulated Depreciation Reserve. *Id.*

Staff requests this unorthodox treatment despite Atmos providing insufficient data that lacked the detail necessary for the Staff to perform an accurate depreciation analysis. (Ex. 107, p. 8). Mr. Gilbert identified the following errors in Atmos' deprecation data: 1) Atmos failed to maintain sufficient plant data to perform a detailed depreciation analysis; 2) Data from seventeen (17) accounts was missing; 3) A disproportionate amount of account transactions list 2005 ending balances; 4) Missing retirement data included missing additions data, dates of removal data, and removal costs data; and 5) Insufficient net salvage data. (Tr. 186-187). Atmos failed to maintain plant data as required by 4 CSR 240-40.040. As a result, the Staff was unable to determine a theoretical reserve for each account and has based its proposal for a negative amortization of $591,000 on data that is not known and measurable. (Tr. 188, 210-211). Mr. Gilbert testified that he was unable to verify the accuracy of Atmos' data and records and simply "accepted management's recognition and acknowledgment of an over-accrual of depreciation." (Tr. 188-189).

When questioned on Staff's proposal and whether it violated the Uniform System of Accounts, which the Commission's rules require gas utilities to follow under 4 CSR 240-40.040, Mr. Gilbert acknowledged that he lacked the accounting expertise to know the proper accounting treatment for depreciation expense. (Tr. 189, 192). Without a

proper understanding of the accounting implications of Staff's depreciation proposal, Mr. Gilbert's testimony is unreliable and insufficient to support Staff's proposal for a negative amortization of $591,000. The only accountant testifying on the accounting implications, Mr. Trippensee, testified that Staff's proposal is improper accounting because it will force ratepayers to reinvest $591,000 that they have already paid, then require ratepayers to repay this amount plus a return in the future. (Tr. 209-210). Even Mr. Gilbert admitted that future ratepayers would be forced to repay the $591,000. (Tr. 200-201). The Commission should reject Staff's proposal to reduce the annual depreciation expense accrual by $591,000. The Commission should approve the depreciation rates without approving the negative amortization. (Tr. 196).

C. RATE DESIGN

1. ISSUE: What is the appropriate rate structure for residential, small, and medium general service?

Public Counsel opposes the Staff's proposal to move away from the historic or traditional rate design method, which has been and continues to be beneficial to both ratepayers and shareholders, and instead adopt a new "revenue decoupling" rate design. Currently, rates charged to residential ratepayers by every natural gas company in Missouri include a fixed rate element and a volumetric rate element. The fixed rate element has traditionally been priced to correspond to the plant specifically attributed to a residential customer – the service line, regulator and meter. (Tr. 520). The volumetric rate has traditionally been priced to correspond to the remaining costs of the system. Rates and revenues are "coupled" in that the volumetric rate element links the Company's revenue to the gas volumes consumed by ratepayers. Staff's proposal would eliminate the volumetric element, thus relying upon the unproven assumption that the

cost to serve low-volume residential ratepayers is identical to the cost to serve high-volume residential ratepayers. Staff's rationale is erroneous because Atmos' distribution system was designed according to the volumetric demand of the customers in an area as well as future demand growth. (Tr. 70-72). Larger distribution mains were put in place to serve those demand related needs, and are therefore are not directly related to the number of customers. High-volume customers use greater capacity and should reasonably pay more toward recovery of demand related costs. "Value of service to customers" is an element that Atmos considers relevant to designing rates. (Tr. 72). Fittingly, the value of service to a residential high volume user is greater than the value of service to a residential low-volume user. Such differences in demand and values of service are factors addressed through a rate design that maintains a volumetric rate element.

For the additional reasons detailed below, Public Counsel recommends that no changes be made to the rate structure for residential service. Staff's testimony indicating an over-earning clearly suggests Atmos' current rate design is more than sufficient to meet Atmos' revenue needs. The Commission has recently determined that the existing rate design is just and reasonable, and absent sufficient justification to change that rate design, the Commission should reject making rate design changes when no increase in revenue is necessary.

a. Staff's Rate Design Proposal is Contrary to Sound Energy Efficiency and Conservation Policies

The current volumetric rate element is directly tied to the customer's usage. If the customer uses more, the customer pays more, and the utility earns more. Likewise, if the customer makes efforts to curtail usage and lower the dollar amount of the customer's

monthly bill, the consumer benefits through a lower gas bill. In a similar fashion, warmer weather creates a lesser need for space heating and the customers also see a benefit under a volumetric rate element. Removing the volumetric piece from residential rate design will create a disincentive for consumers to conserve. Today a customer can reduce the non-gas portion of the customer's bill by reducing consumption. Under the Staff's rate design customers lose that ability, which clearly diminishes a customer's incentive to conserve. Staff's proposal offers no counter balancing incentives to customers, nor does it offer any assurances that Atmos will make efforts to encourage conservation. (Ex. 201, p. 19). In fact Staff's proposal creates a *disincentive* for Atmos to encourage conservation because the costs of any such programs would voluntarily come from Atmos at the shareholders' expense. (Tr. 313). Without any significant and meaningful counterbalancing program to encourage conservation, Staff's rate design proposal will be a drastic step backwards during a time when Staff and the Commission should be promoting strong efficiency and conservation incentives.

Energy efficiency programs are being adopted and encouraged nationwide, which emphasizes the lack of consideration energy efficiency played into the Staff's rate design proposal. In the ***National Action Plan for Energy Efficiency***, the plan developed in 2006 by more than fifty leaders of regulatory and industry organizations and cited to earlier in this brief, the "overall goal" of the Plan "is to create a sustainable, aggressive national commitment to energy efficiency through gas and electric utilities, utility regulators, and partner organizations." (Ex. 4, Schedule GLS-2, p. ES-2). The Plan presents an extensive review of energy efficiency programs nationwide and repeatedly encourages regulators to "aggressively pursue energy efficiency opportunities." The

Plan also highlights the importance that education programs play in promoting energy efficiency when designing rates. The Staff's rate design is far from an aggressive pursuit of energy efficiency, and lacks any education or efficiency programs. Staff merely relies upon Atmos to propose programs, and the programs finally agreed to by Atmos would provide energy audits and would weatherize thirty (30) homes annually. However, Atmos proposed programs lack any detail to determine whether such programs would provide real benefits. (Tr. 540). Staff's Exhibit 144, a packet of information regarding energy efficiency and conservation programs, reveals the benefits available if more effort is spent implementing programs. The 2006 Midwest Natural Gas Initiative concluded that "a modestly aggressive, but pragmatically achievable, energy efficiency campaign (achieving on the order of a 5 percent reduction in both electricity and natural gas customer use over 5 years) could produce tens of billions of dollars in net cost savings for residential, commercial, and industrial customers in the Midwest." (Ex. 144, Part 2, Section 1, p. 37). Sample programs offered around the nation include such benefits as rebates for replacing older furnaces with high-efficiency furnaces. Consistent among the programs offered is the importance of a comprehensive education and marketing campaign that aims to increase consumer awareness of programs such as Energy Star. *Id.* Another beneficial program that the Commission viewed favorably in Case No. GR-2004-0209 is the Pay As You Save (PAYS) proposal, which received no attention from Staff or Atmos in this case. (Tr. 543-544, 578). Approval of a rate design proposal that removes most of Atmos' business risk and guarantees that Atmos will earn its authorized return deserves in return a significantly more focused and meaningful approach towards conservation and energy efficiency.

b. Staff's Rate Design Harms Low-Volume Users

The Staff's proposed decoupling rate design would create negative impacts on low-volume ratepayers. Based on an analysis of a two-year period of data obtained by the Staff from Atmos, Public Counsel determined that the lowest use customers would pay 52% to 173% more depending on the district in which those customers reside. (Ex. 201, p. 11). This occurs because decoupling shifts revenue responsibility within the residential rate class from high-volume users to low-volume users. It was this very shift and the burden it places on low-volume users that caused Staff witness Dr. Michael Proctor, just a few years ago in Case No. GR-2002-356, to oppose a rate design proposal that would recover all non-gas costs in the customer charge and would be detrimental to low-use customers. (Ex. 201, p. 12-13). Public Counsel's evidence shows that the Staff's rate design proposal could nearly double the non gas recovery on some low use customers' bills that do not have the ability to avoid the increase by curbing use. (Ex. 202, p. 12).

During the evidentiary hearing, Staff witness Ms. Ross testified that the Staff did no study to determine the impact Staff's rate design proposal would have on Atmos' customers. Staff did not determine the number of low-use customers that would be impacted by the proposal, and did not consider whether such proposal would cause low-use customers to simply drop off the system. (Tr. 308, 311). When asked how low-use customer in Kirksville on a fixed income would find the resources to pay for the large annual increase they would see under Staff's rate design, Ms. Ross had no answer. (Tr. 310). Ms. Ross further testified that low-use customers would benefit from "[t]he

satisfaction of paying the cost to serve them," yet admitted in the very next question that she does not know the cost to serve these customers because no study was conducted. (Tr. 310-311). Shifting more revenue responsibility onto low-use consumers is especially troubling for areas of Atmos service territory, such as the Southeast Missouri (SEMO) area, where low-income households are prevalent more so than in Atmos' other service areas. (Ex. 206, Tr. 573). The SEMO area constitutes the majority of Atmos customers and also the majority of LIHEAP customers, thus indicating that the impact on Atmos low-usage customers could hit the SEMO area the hardest. Without studies that determine the impact of this rate design on low-use and low-income households, the Staff's rate design proposal lacks the support necessary to back a finding that drastically altering historic rate design is consistent with good public policy.

c. Staff's Rate Design Offers No Reductions in Rate of Return to Reflect the Corresponding Reduction in Risk

The decoupling rate design proposal recommended by Staff and supported by Atmos offers no corresponding reduction in Atmos' rate of return to reflect the significant reduction in weather risk. By ensuring recovery of a set level of revenue, the impact weather plays on Atmos' earnings essentially disappears. In a recent case wherein the Commission approved an experimental weather mitigation rate design, an agreement of the parties, including Laclede Gas Company, was that the impact on the company's risk was a factor considered when mitigating weather effects. (Ex. 201, p. 17). Under Staff's rate design proposal, "the Commission determined non-gas revenue requirement (including ROE) intended to be collected will in fact be collected." (Ex. 203, p. 6). Accordingly, the risk of earnings variability is greatly reduced. *Id.* If the Commission fails to recognize this reduction in risk, the result would be rates "paid by customers that

compensate stockholders for a risk they no longer have, therefore such rates would not be just and reasonable." *Id.*

d. Staff's Rate Design Contradicts Ratepayer Expectations

Staff's decoupling rate design proposal is contrary to good public policy because it would be contrary to ratepayer's expectations that consuming less gas will lower the non-gas portion of the customer's bill. Staff witness Ms. Anne Ross acknowledges that customers may feel the rate design proposal is unfair. (Ex. 113, p. 15). Unfortunately, consumers were not made aware of this proposal in the mailed customer notice, and were unable to comment on reducing their ability to conserve or on requiring low-volume users to pay the same as high-volume users.[4] In fact, the public hearings occurred less than a week after the Staff first proposed this new change to the traditional rate design expected by all customers. Consumers were denied an opportunity to comment on this proposal, which will be especially significant to customers that receive a $166.65 annual increase (Ex. 201, Schedule 8) when the notice provided to them stated the average increase would be $4.68 per month, or $56.16 annually. Low-use residential consumers would likely assume that they would fall under a $4.68 per month increase because rates have traditionally been tied to usage and there was no indication from the Commission or Atmos that anything different was being proposed. Ratepayers deserve an ample opportunity to understand and respond to this proposal before being blindsided with a drastic change to the way rates are designed.

[4] *Suspension Order and Notice, Order Setting Hearings, and Order Directing Filing,* Case No. GR-2006-0387, April 13, 2006.

e. Staff's Rate Design Reduces Atmos' Incentives to Operate Efficiently

The Staff's rate design proposal reduces incentives for Atmos to operate efficiently. (Ex. 203, p. 11). The weather risk associated with traditional rate design creates an incentive for utility companies to mitigate that risk by operating the utility efficiently. If the utility experiences warmer than normal weather and the lower consumption levels reduce earnings, any cost savings realized through efficient improvements will help mitigate the impact of the decreased earnings. By reducing the company's risk as proposed by Staff's rate design, the utility has less incentive to create efficiencies because the utility is ensured a level of earnings. *Id.* This process mimics a competitive business environment by creating incentives for MGE to minimize costs. (Ex. 201, p. 21).

f. Staff's Rate Design Assumes a Guaranteed Return

The Staff's rate design proposal appears to be based on the misguided legal premise that utilities should be guaranteed a certain level of revenues. Rates are not set or designed to provide uniform recovery each year. Rates are set to provide an opportunity to earn a return incorporated in the revenue requirement. In *State ex rel., Missouri Public Service Co. v. Fraas*, 627 S.W.2d 882 (App. W.D. 1981), the Western District held that a tariffed rate is intended to only permit an opportunity to make the percentage return approved by the PSC, and guarantees no specific return. The Court compared this opportunity to a hunting or fishing license, which does not guarantee that the holder will catch anything at all - it simply makes the catch legal provided the holder is successful in his own efforts. Staff's rate design proposal, however, would essentially guarantee a specific return. Utility regulation should mimic a competitive market, not an

unregulated monopoly market. Earnings uncertainty motivates competitive business entities to minimize costs and to strive for customer satisfaction. (Ex. 201, p. 22).

Approving the Staff's revenue decoupling proposal, and making this major change to historical rate design, will essentially change a balance that has proven successful throughout the life of this Commission. That balance is struck by not guaranteeing a level of return, but by only requiring a just and reasonable rate. The Missouri Supreme Court in *Straube v. Bowling Green Gas Co.*, 227 SW2d 666 (Mo. 1950) found that the ultimate return that results from the rates fixed, charged and collected will "necessarily vary from time to time" because "the law, of course, did not require that the rates at any time yield any particular return."

Staff's rate design not only guarantees a return, but offers no true-up procedure to provide a review for this untested change in rate design. One "critical element of revenue decoupling is a true-up of actual results to forecasted results," according to the ***National Action Plan for Energy Efficiency***. The *Plan* leadership concluded that a "decoupling plan would typically last a few years and could be changed to reflect new circumstances and lessons learned." (Ex. 4, Schedule GLS-2, p. 2-4). Staff's proposal simply guarantees revenue without a true-up procedure to make necessary changes and reflect lessons learned.

g. Past Commission Decisions Have Found Staff's Rate Design to be Contrary to Good Public Policy

The Commission recently considered a rate design proposal that would increase MGE's fixed rate element and reduce MGE's volumetric rate element. While not as drastic a change as that being proposed by the Staff for Atmos, the Commission nonetheless found that placing more than 55% into a fixed charge to be poor public

policy. MGE had proposed a "weather mitigation" rate design "to avoid volatility in the company's revenue stream." The Commission rejected MGE's proposal and held:

> High fixed monthly customer charges tend to defeat customer efforts to reduce their bill by conserving natural gas. As a result, the Commission finds that the public interest is best served by setting customer charges as low as reasonably possible. …
>
> The result of the proposed rate design would allow MGE to recover a greater percentage of its costs even when warm weather results in the sale and consumption of fewer units of natural gas.
>
> Staff opposes MGE's weather mitigation rate design proposal, but Public Counsel voices the most vehement opposition. Public Counsel correctly points out that the proposed rate design would reduce MGE's risk associated with warmer than normal weather by effectively creating a second, fixed, customer charge. As a result, customers would not receive as much of a benefit from warmer than normal weather. Furthermore, customers would have less ability to lower their bills by conserving energy. As the Commission found in its discussion of fixed rate elements, such a result is contrary to good public policy.[5]

The Commission determined that the "current ratio between fixed and volumetric rate elements, whereby MGE recovers approximately 55% of its residential distribution revenues from fixed elements, is appropriate." Under Staff's proposal for Atmos, Atmos would recover 100% of its residential distribution revenues from fixed elements. This continues to be contrary to good public policy for the same reasons identified by the Commission just two years ago. Customers would not receive as much of a benefit from warmer than normal weather, and would have less ability to lower their bills by conserving energy. Public Counsel is not aware of any case where the Commission approved a rate design similar to what the Staff has proposed.

h. Staff's Rate Design is Not Supported by NARUC or Other States

Staff's testimony rate design proposal relies in part upon a NARUC resolution that identifies companies in other states that have decoupling tariffs. Staff apparently misread NARUC's resolution to assert that decoupling rate design *in and of itself* promotes conservation and efficiency. Such is not the case. The NARUC resolution was clearly aimed at promoting conservation and efficiency through programs, and did not suggest that a state commission should guarantee revenue recovery while remaining silent on conservation and efficiency. In fact, the resolution attached to Ms. Ross' testimony clearly states that NARUC encourages "State commissions and other policy makers to support expansion of energy efficiency *programs,* including consumer education, weatherization, and energy efficiency to address regulatory incentives to inefficient use of gas and electricity." [emphasis added]. Staff's rate design proposal lacks any program aimed at promoting conservation and efficiency. Staff's testimony offers no consumer education programs, no weatherization programs and no programs designed to encourage energy efficiency. Staff's rate design merely relies upon Atmos to somehow encourage conservation and efficiency, despite Atmos having no incentive to do so. Public Counsel believes NARUC endorsed a more concerted effort on the part of state commissions rather than reliance upon the industry.

An analysis of the state commission decisions cited by NARUC reveals that of the seven (7) state commissions mentioned – Oregon, Maryland, California, North Carolina, North Dakota, Georgia and Oklahoma, only North Dakota opted for a rate design that would collect all non-gas costs through a uniform fixed rate. One significant difference

[5] *Report and Order,* In the Matter of Missouri Gas Energy's Tariffs to Implement a General Rate Increase for Natural Gas Service, Case No. GR-2004-0209, September 21, 2004.

between the North Dakota proposal and the Staff's proposal is that the North Dakota proposal was accompanied by a reduction in the overall revenue requirement, a distinguishing feature which is missing from the Staff's rate design proposal in the present case.

Other state commissions that have rejected revenue decoupling did so without facing a proposal that would move *all* margin costs to a fixed customer charge. Despite facing proposals far less harmful than the Staff's proposal, these commissions still found legitimate reasons to reject the rate design changes proposed. The Arkansas Public Service Commission considered an adjustment mechanism meant to reflect changes in customer usage and changes in number of customers, and rejected the proposal for several reasons, including: 1) It would "diminish the incentives for the company to minimize costs"; 2) It would inappropriately shift risk from stockholders to customers, and "would not provide an equitable balance between the interests of the Company and its customers"; and 3) It would not provide the company sufficient incentive to promote growth of its service territory.[6] The Arizona Commerce Commission also rejected a revenue decoupling rate design proposal and encouraged "the parties to this proceeding to seek rate design alternatives that will truly encourage conservation efforts, while at the same time providing benefits to all affected stakeholders."[7]

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[6] Arkansas Public Service Commission, *Order*, Docket No. 04-121-U, Order No. 16, *In The Matter Of An Application For A General Change Or Modification In Centerpoint Energy Arkla, A Division Of Centerpoint Energy Resources Corp's Rates, Charges, And Tariffs*, 2005 Ark PUC LEXIS 349, September 19, 2005.

[7] Arizona Corporation Commission, *Opinion and Order*, Docket No. G-01551A-04-0876; Decision No. 68487, *In The Matter Of The Application Of Southwest Gas Corporation For Establishment Of Just And Reasonable Rates And Charges Designed To Realize A Reasonable Rate Of Return On The Fair Value Of The Properties Of Southwest Gas Corporation Devoted To Its Operations Throughout The State Of Arizona*, 247 P.U.R.4th 243, February 23, 2006.

i. Public Counsel's Rate Design Conclusion

No state has adopted a revenue decoupling proposal as radical, untested and unfriendly to consumers as the proposal before the Commission in this case. Public Counsel urges the Commission not to make these drastic changes to historical regulation practices without a better effort to determine whether these changes are necessary and whether they provide the best alternative available. Staff and Atmos have failed to satisfy their burden of proving that the traditional rate design is harmful to shareholders and in need of reform. Shareholders are doing very well under the existing rate design, evident by Atmos' over-earning. The traditional rate design allows Atmos to file a rate case should rate adjustments be necessary, which ensures periodic rate review by the Commission. This traditional approach has been successful in satisfying both consumers and shareholders, and it would be a disservice to consumers to implement a knee-jerk reaction to claims by utilities that the environment LDCs are operating under today requires such drastic changes.

Should the Commission feel the need to explore additional rate design methods, Public Counsel believes more time and resources should be spent exploring the different rate design options available. More resources should also be devoted to exploring whether a realistic "problem" with traditional rate design truly exists. The ***National Action Plan for Energy Efficiency*** describes how an early 1990s attempt to create decoupling systems by several state commissions failed. "In all cases, decoupling was discontinued by the end of the decade." (Ex. 4, Schedule GLS-2, p. 2-5). This emphasizes the need to take more than a cursory look at revenue decoupling and to carefully analyze lessons learned nationally. By learning from the failed attempts of

other states and the successes of more recent attempts to make rate design changes, the Commission would be much better prepared to make any needed changes to the traditional rate design approach.

2. ISSUE: What is the appropriate structure for the small general service rate (including the medium general service rate if the small general service class is split)?

Public Counsel believes the Commission should maintain the existing structure for the entire small general service (SGS) rate class. The Staff seeks to divide the SGS class so that customers using more than 2,000 Ccf per year will retain the traditional rate structure while SGS customers at or below 2,000 Ccf will be subject to the same rate design Staff proposed for residential ratepayers. Public Counsel's foremost concern with Staff's proposal is the discontinuity it will create within the SGS class. If the Commission approves Staff's rate design proposal, SGS customers using 2,001 Ccf will pay roughly two to three times as much in non-gas rates as a customer using 2,000 Ccf. (Ex. 201, p. 26). The inherent unfairness of this proposal is obvious. Notably, the Staff abandoned this proposed change to the SGS class in its subsequent SGS recommendations in Case No. GR-2006-0422 for MGE. (Tr. 426).

D. MISCELLANEOUS CHARGES

1. ISSUE: What are the appropriate miscellaneous charges (activation charges for connection, reconnection, and transfer; late payment, NSF, and seasonal reconnection)?

These rates vary substantially by district for the miscellaneous charges, and there is no compelling reasons presented in the testimony to alter or raise the existing rates. High cc for the notion that existing customers are made significantly worse off by retaining a lower connection charge for new customers." (Ex. 201, p. 37).

Similar arguments exist for high reconnection charges. In addition, where the reconnection fee is set at a rate that is too high for low income users to overcome, it is "reasonable to assume the Company would face an increased risk of writing off uncollectibles," which would "flow through to the remaining customer base."(Ex. 201, p. 38). The record provides no compelling reasons to increase the burden on users already facing financial hardships, or to increase the overall burden on the remaining customer base. Public Counsel recommends that the Commission recognize that the burden from these miscellaneous charges may be insignificant to many ratepayers, but could create an insurmountable burden for low income consumers.

a. Seasonal Disconnects

Public Counsel opposes the seasonal disconnect proposal that would deny customers the ability to avoid current non-gas volumetric based charges by forgoing service in the summer. When coupled with the Staff's rate design proposal to eliminate the volumetric rate portion of non-gas costs, customers will be held hostage to a service that may be unnecessary to the customer in the summer months. Under the new proposal, seasonal disconnect customers will be forced to pay a significantly higher amount to regain service for the winter season. Staff's proposal would likely create a substantial barrier to low-income customers that find it necessary to deprive themselves of the service during the summer. It will also put a greater drain on resources meant to help low-income customers get reconnected to the system such as LIHEAP. (Tr. 652). The most glaring problem with the seasonal disconnect proposal is the peripheral impacts on customers that may have a legitimate reason to forego service. For example, students returning to school would be forced to pay for service during the summer of their

absence. (Tr. 653). An elderly resident hospitalized for an extended period of time would be forced to pay for a service she did not use during her absence. *Id.* And a soldier deployed overseas for eleven (11) months would be required to pay for gas service he did not use during his deployment. *Id.* These reasons highlight the failure of the seasonal disconnect proposal's ability to protect consumers.

E. DISTRICT CONSOLIDATION

1. ISSUE: Should the Company's districts be consolidated for purposes of setting margin non-gas rates in this case?

Public Counsel opposes consolidating Atmos' districts without "comprehensive data on which to base consolidation or district specific class shifts." (Ex. 202, p. 3). Even if the Commission were to order a zero revenue increase, consolidating districts would cause customer bills to change from a 29% decrease to a 67% increase depending on the district. (Ex. 202, p. 4). With the parties proposing no shifts between classes, and Atmos agreeing to a zero revenue increase, there is no reason for the Commission to generate the customer confusion that would occur if customers experienced a drastic rate change in a case where the Commission rejected the proposed revenue increase.

Staff witness Ms. Ross concludes that the cost to serve similarly situated customers in contiguous districts is approximately the same. This conclusion is based upon mere speculation. Staff has provided no evidence to suggest the embedded district costs are the same. Ms. Ross' conclusion ignores the fact that the embedded cost of mains varies significantly by district. (Ex. 202, p. 7). The density, depreciation rates and other factors of each legacy district will influence the mains costs. (Ex. 202, p. 7). Public Counsel's testimony shows that Staff's Accounting Schedules indicate that there are indeed significant differences in the embedded costs of each district. (Ex. 202, p. 11).

Without reviewing real cost data, a decision to consolidate districts would be unreasonable and unsupported by the record. Staff performed cost studies for the three proposed consolidated districts but acknowledged that it did not determine the cost to serve each of the existing districts. The limited cost evidence available for the consolidated districts shows that the booked costs for meters and regulators is not the same for residential customers statewide. (Tr. 293-294). Further, Staff witness Ms. Ross testified that the costs to serve a customer in one consolidated district is not the same to serve a customer in another consolidated district, and specifically identified differences in the vintage equipment, different depreciation rates, and different plant replacement rates. (Tr. 294-295). It is likely that similar differences in the vintage equipment, different depreciation rates, and different plant replacement rates exist between the districts the Staff proposes to consolidate.

A decision to consolidate districts should be based on reliable data that factors in the costs of serving each district as well as the impacts that will be forced upon consumers. Unfortunately, the record before the Commission lacks the necessary data to consolidate districts. First, Atmos has not prepared a cost of service study and has not prepared a study to determine the cost of replacing mains. (Tr. 69). Had Atmos performed a cost study, it would have revealed that Atmos designs main extensions based on modeling considerations such as load requirements – suggesting that the load requirements for different areas, including different districts, is different and requires differently sized mains. (Tr. 71). In other words, the costs to serve customers differs according to location, thus dispelling the notion that the embedded costs are the same for each district.

F. PGA CONSOLIDATION

1. Should the Company's PGA tariffs be consolidated for purposes of setting gas rates in this case?

This issue asks whether the Company's Purchased Gas Adjustment (PGA) tariffs should be consolidated for purposes of setting gas rates in this case. Atmos proposed a single statewide rate, whereas Staff proposed consolidating the existing rates into three (3) rates based on the underlying pipeline serving each area. Public Counsel opposes PGA consolidation. The rates vary significantly among districts, and the parties have offered no compelling reason other than administrative burden to alter the PGA structure. Gas costs represent 73% to 82% of a customer's bill, and consolidating could have a substantial negative impact on customers in areas with lower rates.

G. OTHER TARIFF ISSUES

1. Should a cash-out policy be implemented?

2. Should the Commission allow third party administered pools for cash-outs?

Atmos proposes to replace the current penalty structure with a fee and payment schedule for imbalances caused by transport customers taking more or less gas from the system than the amount under contract. Atmos also proposes to allow third parties to create pools that would allow pool members to offset imbalances. Public Counsel is concerned with these proposals because they give large volume customers flexibility at residential ratepayer's expense, allowing them to borrow or repay the use of gas at their discretion. This creates a concern because residential and small business class users rely on the company for their gas, but under this proposal would be subservient to the needs of the large volume users. Under the current structure, in all districts but Greeley the

Company already has protections or penalties in place to restrict imbalances. Public Counsel believes this is preferable over the Company's proposal to implement a cash-out policy.

3. What is the appropriate level of lost and unaccounted gas?

Public Counsel supports the corrective actions proposed by Staff and believes the 2% level supported by the Staff is acceptable provided that residential and small businesses are "held harmless from excessive line loss in the event that an investigation reveals actual line loss instead of faulty read equipment." (Ex. 202, p. 40).

4. Should the Commission approve an Economic Development Rider?

Any Economic Development Riders (EDR) approved by the Commission should not be funded by ratepayers. Atmos has not provided support for the notion that requiring ratepayers to fund an EDR is just and reasonable. Public Counsel would support an EDR funded by shareholders. (Ex. 202, p. 40).

5. Should the mains extension policy and the determination of amounts to be charged be changed in this case?

Public Counsel believes the Company's proposal to eliminate the minimum line extension, and subject every new residential and small business customer to a feasibility review resulting in an up front fee for main extensions, should be rejected. "A reasonable fee-free line extension is both a reasonable obligation to impose on a public utility and an investment in future earnings for the utility." (Ex. 202, p. 38-39).

III. CONCLUSION

Public Counsel asks that the Commission listen closely to the concerns of the low-income and senior citizen ratepayers that appeared at the public hearings opposing Atmos' rate increase. Ms. Linda Vincent testified during the Hayti public hearing that her income is fixed. Senior citizens such as Ms. Vincent are not able to absorb such rate increases that force many elderly Missourians to choose between eating, heating or medicine. (Tr. 14). Missouri consumers, including the most vulnerable elderly on fixed incomes, should not be forced to make such a choice between these essential purchases unless it is *absolutely imperative.* Neither Staff nor Atmos have presented evidence that supports a finding that the changes requested in this case, especially those changes with rate implications, are imperative much less just and reasonable. Ratepayers living on fixed incomes are not afforded the luxury of filing with the Commission for an increase in income. The Commission should carefully examine the changes requested in this case and deny changes that fail to serve the public. While it is true that the law requires the Commission to employ ratemaking principles that give the utility a reasonable opportunity to earn a fair return on its shareholder's investments, the foremost purpose of the Commission is to serve and protect ratepayers. *State ex rel. Capital City Water Co. v. P.S.C.,* 850 SW2d 903 (Mo. App. W.D. 1993). The protection given the utility "is merely incidental." *State ex rel. Electric Co. of Missouri v. Atkinson,* 204 SW 897 (Mo. 1918). The public is not served by a Commission decision that guarantees revenue recovery for the utility while providing no benefits to ratepayers.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been sent via email on this 19th day of January 2007:

/s/ Marc D. Poston

Marc D. Poston