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Witness: CHARLES R. HYNEMAN
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

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REBUTTAL TESTIMONY

OF

CHARLES R. HYNEMAN

ATMOS ENGERY COMPANY
and
ASSOCIATED NATURAL GAS COMPANY

CASE NO. GM-2000-312

Jefferson City, Missouri
February, 2000

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CASE NO. GM-2000-312

Q. Please state your name and business address.

A. Charles R. Hyneman, 3675 Noland Road, Suite 110, Independence, Missouri 64055.

Q. Please describe your educational background and work experience.

A. I graduated from Indiana State University in May 1985 with a Bachelor of Science degree in Accounting and Business Administration. I also earned a Masters of Business Administration degree from the University of Missouri – Columbia in December 1988. In May 1985, I was commissioned as an officer in the United States Air Force. I left the Air Force in December of 1992 and joined the Commission in April of 1993. I am a Certified Public Accountant holding certification in the state of Missouri.

Q. Have you previously filed testimony before this Commission?

A. Yes. A listing of the cases in which I have previously filed testimony before this Commission is given in Schedule 1, which is attached to this rebuttal testimony.

Q. With reference to Case No. GM-2000-312, have you examined the books and records of Atmos Energy Corporation (Atmos) and Southwestern Energy Company (SWEN), collectively referred to as the Joint Applicants?

A. Yes, with the assistance of other members of the Commission Staff (Staff).

Q. What is the purpose of this rebuttal testimony?

A. The purpose of this rebuttal testimony is to present to the Commission three ratemaking consequences of Atmos' Application to purchase the Missouri gas properties of Associated Natural Gas (ANG), which the Staff considers to be detrimental to ANG's Missouri ratepayers.

Q. Briefly describe Atmos Energy Corporation.

A. Atmos began providing utility service in Missouri with the acquisition of Greeley Gas Company, which became final on December 22, 1993. Atmos expanded its operations in Missouri when, on March 19, 1997, the Commission approved the merger of Atmos with United Cities Gas Company (United Cities). United Cities has maintained its corporate identity and is organized as an operating division. Atmos now provides natural gas and propane to more than one million customers in 13 states through its operating divisions – Energas Company, Greeley Gas Company, Trans Louisiana Gas Company, United Cities Gas Company, Western Kentucky Gas Company and United Cities Propane Gas, Inc.

Q. What is the history of ANG?

A. ANG currently serves approximately 69,000 customers in northeast Arkansas, southeast Missouri (SEMO), and the towns of Butler and Kirksville in western and northern Missouri, respectively. ANG has approximately 48,000 customers in Missouri. Associated currently has 152 employees (91 in Missouri) working in its service areas.

ANG was formed in the late 1940s by a group of private investors in southeast Missouri. During the same time period, Ark-Mo Power developed systems in northeast Arkansas and parts of southeast Missouri not served by ANG. In the early 1950's, Ark-Mo Power took over ANG but continued operating it as a separate entity. ANG's Kirksville System was constructed in 1961-1962 and the Butler System was acquired in 1963 from Missouri Western Gas Company. In 1971, Ark-Mo Power was merged into Middle South Utilities, now known as Entergy. In 1978, Ark-Mo Power moved all of its gas utility assets into ANG and in 1981, Ark-Mo was dissolved. At that time, ANG became a subsidiary of Arkansas Power & Light, another subsidiary of Middle South Utilities. ANG's assets were sold to Arkansas Western Gas Company (AWG), a SWEN subsidiary in 1988. ANG now operates as a division of AWG.

Q. What purchase price was agreed upon for ANG's Missouri gas assets?

A. The Agreement provides for a payment of $32 million by Atmos for these assets.

Q. Is there an acquisition premium associated with the purchase price of ANG's Missouri assets?

A. Yes. For regulated companies, an acquisition "premium" represents an amount paid for an item in excess of its net book value. In this instance, the net book value of ANG's Missouri gas properties is $28.4 million. Subtracting this amount from the $32 million purchase price leaves an acquisition premium of $3.6 million. This premium amounts to approximately 12.7 percent of ANG's equity investment in these assets, and will be recorded as a gain on the sale of plant assets to be enjoyed by the shareholders of SWEN. I should note for the purposes of this testimony, the terms "acquisition premium" and "acquisition adjustment" are synonymous.

Q. What is the standard used by the Commission in considering the request by Atmos to purchase the ANG's Missouri gas assets?

A. It is my understanding that the Commission must find that the proposed transaction is not detrimental to the public interest.

Q. Has the Staff considered whether any potential detriments to the public interest may exist as a result of the proposed transaction?

A. Yes. The Staff asserts that the following issues, if not cured by the Commission in any Order conditionally approving this Application, constitute a detriment to the public. If the Joint Applicants are not willing to abide by any of the conditions ordered by the Commission, then the Commission should reject this Application outright. Three potential ratemaking detriments are:

1. The possibility of future rate recovery of any acquisition adjustment resulting from this transaction.

2. The failure of Atmos to agree to compensate Missouri ratepayers for the loss of the deferred tax reserve rate base offset currently on the books and records of ANG.

3. The failure of SWEN to agree to transfer the ANG employees' pro rata share of excess pension assets to Atmos' pension plan.

Acquisition Adjustment Issue

Q. What condition related to the acquisition adjustment detriment is the Staff recommending be placed on any approval of this transaction by the Commission?

A. The Staff recommends that the Commission impose the requirement that Atmos will not seek rate recovery in any future rate proceeding of any acquisition adjustment incurred in the acquisition of ANG's Missouri gas properties.

Q. Please define "acquisition adjustment."

A. An acquisition adjustment represents the amount by which the sales price of a property exceeds or is less than its net book value, which is the original cost of the asset when first placed in service less accumulated depreciation. The Uniform System of Accounts for all public utility industries prescribes that the amount of an acquisition adjustment be accounted for in a separate account from the original net book cost of the utility property in question.

Q. Has the Missouri Commission reflected acquisition adjustments in rates in past rate proceedings?

A. No. The Staff is not aware of any case in which the Commission has authorized rate recovery of an acquisition adjustment, either through an amortization to expense or by allowing a return on an acquisition adjustment through inclusion in rate base. The Staff, as a matter of policy based on public/ratepayer detriment, opposes above-the-line treatment of acquisition adjustments for rate purposes ("above-the-line" means included in customer rates).

Q. Is Atmos seeking specific rate treatment in this proceeding of the acquisition adjustment it will incur upon the purchase of ANG's Missouri assets?

A. No. The Joint Application is silent with respect to rate recovery of the acquisition adjustment. In response to Staff Data Request No. 2, however, the Company stated that it "is still evaluating whether to seek rate recovery" of the acquisition adjustment.

Q. If Atmos is not seeking a determination of the future rate recovery of the acquisition adjustment in this Application, why is the Staff addressing the issue in this docket?

A. The Staff takes the position that even the possibility of above-the-line treatment of acquisition adjustments in future rate proceedings constitutes a detriment to the public. The Staff is firm in its belief that for financially viable utility companies, above-the-line treatment of acquisition adjustments is never warranted for rate purposes.

Q. Please explain.

A. Charging customers in rates for acquisition adjustments in essence makes a utility's customers pay for the cost of mergers and acquisitions. This is inappropriate for several reasons.

First, acquisitions and mergers are voluntary actions on the part of utilities, and are rarely, if ever, required in order to provide safe and adequate service to customers. For this reason, the cost of mergers (acquisition adjustments and merger related transaction costs) should generally be considered the responsibility of utility shareholders.

Another reason why it is not appropriate for ratepayers to pay for merger and acquisition costs is that when a premium above net book value is paid for utility assets, by definition, the selling utility's shareholders (and not its customers) realize a financial gain on the sale. This Commission has consistently ruled that gains (and losses) on the sale of plant assets should be treated below the line and not flowed through to cost of service. Above-the-line treatment of acquisition adjustments would be inconsistent with how the Commission has historically treated gains and losses on asset sales.

Q. Please describe the Commission's reasoning for treating gains on sales of plant assets below-the-line.

A. Although the Commission has modified its reasoning over the years, it has consistently ruled that asset gains and losses should be treated below-the-line for ratemaking purposes.

In Case No. ER-77-118, involving Kansas City Power & Light Company, the Commission held that ratepayers do not become owners of the utility by paying their utility bills and therefore are not entitled to benefit from any gains on sale of plant assets. In its Report and Order decided on October 20, 1977, the Commission ruled:

> It is the Commission's position that ratepayers do not acquire any right, title and interest to the Company's property simply by paying their electric bills. It should be pointed out that Company investors finance Company while Company's ratepayers pay the cost of financing and do not thereby acquire an ownership position. Therefore, the Commission finds that the disposal of Company property at a gain does not entitle its ratepayers to benefit from that gain nor does the disposal of Company property at a loss require that Company's ratepayers absorb that loss.

A few years later, in Case No. GM-81-368, involving Associated Natural Gas Company, the Commission again ordered that the gain on sale of utility assets recognized by ANG should be treated below-the-line for rate purposes. In this case, however, the Commission stated that its decision was based on its interpretation of a General Instruction included in the Uniform Systems of Accounts. The Commission's Supplemental Report and Order stated that "It should be made clear that "below the line" treatment of the gain on sales of the Kennett gas properties is not indicative of a general policy to treat the gain on sale of utility property in this same manner as to other utilities in future cases."

The Commission also addressed this issue in Case Nos. EO-85-185 and EO-85-224, Kansas City Power & Light Company, decided on April 23, 1986. In this case, the Staff proposed that KCPL's gain on the sale of unimproved land that had been included in KCPL's rate base for over 20 years should be treated above the line. The Commission agreed with KCPL's position that ratepayers have no property interests in the utility assets; however, it said that "this fact alone does not dictate below the line accounting treatment for a gain on utility assets." The Commission relied on the facts and circumstances of this case in arriving at its decision to treat the gain on sale below the line.

Q. Explain how a gain on the sale of utility assets is recognized and how rate recognition of this acquisition adjustment is actually forcing ratepayers to pay for the gain by the selling shareholders.

A. As described earlier, SWEN will recognize a gain on the sale of ANG's Missouri gas assets of approximately $3.6 million, which will accrue to the benefit of SWEN's shareholders as owners of the assets sold. By seeking to recover this $3.6 million in rates, Atmos will be charging Missouri ratepayers for the gain enjoyed by SWEN's shareholders.

Q. Has Atmos recently realized a substantial gain on the sale of utility assets which completely accrued to the benefit of Atmos' shareholders?

A. Yes. According to Atmos' Annual Report filed December 14, 1999, with the Securities and Exchange Commission (SEC), Form 10-K405, in 1998, Atmos sold United Cities' former headquarters office building in Brentwood, Tennessee; two office buildings and a piece of land in Franklin, Tennessee that United Cities had held for investment; and an airplane. The Company realized a gain on the sale of assets totaling $3.3 million.

Q. If Atmos were to seek recovery of the estimated $3.6 million acquisition premium it will pay to SWEN's shareholders, wouldn't consistency require Atmos to also propose above-the-line treatment of any gains on the sale of Missouri jurisdictional assets?

A. Yes, absolutely. An acquisition premium paid by the acquiring utility and a gain on sale of utility assets realized by the selling utility are exactly the same and require similar ratemaking treatment. In fact, in any case where a utility company is seeking rate recovery of an acquisition premium, I would certainly recommend to the Commission that if it grants recovery of the acquisition premium, it should also require similar treatment of any gains on sale enjoyed by the utility since the date of the merger. For example, if Atmos is allowed to seek rate recovery of the acquisition adjustment paid to acquire ANG, then consistency and fairness in the application of ratemaking principles would require that Atmos defer on its books and records as a regulatory liability any part of the gain on asset sales that was related to assets included in Missouri jurisdictional rate base. This deferred liability would then be included in Atmos' cost of service in its next Missouri rate case.

If it is fair for Atmos to seek rate recovery of an acquisition premium it paid to the shareholders of the company selling the utility assets, then it would only be fair for Atmos to offset this added cost of service with the gain the company realizes on any utility assets it sells or otherwise disposes of.

Q. Please continue with your third reason why it is inappropriate to charge utility ratepayers for the costs of mergers and acquisitions.

A. Determinations of the purchase price of utility stock or assets is an inherently subjective process, and does not depend solely upon a consideration of cost of service savings or benefits that may accrue to customers as a result of the transaction. In fact, in some cases, perceived nonregulated or nonutility benefits may play an important role in both a utility's decision to purchase stock or assets, and its evaluation of the purchase price to be paid for such items. For this reason, the Staff does not believe the Commission should assume either the role of assessing the reasonableness of a utility's subjectively determined purchase price for stock or assets, or the responsibility of assigning some portion of the acquisition adjustment to nonregulated operations. To allow recovery of an acquisition adjustment in rates, of course, would force the Commission to make exactly those assessments.

Q. Do you have an example of how the purchase price paid by Atmos to SWEN could have been influenced by potential financial benefits to an Atmos' unregulated subsidiary?

A. Yes. Atmos owns a 45 percent interest in Woodward Marketing, L.L.C. (Woodward) of Houston, Texas. Woodward provides natural gas services to Atmos, industrial customers, municipalities and natural gas utilities. According to its 1997 Annual Report to Shareholders, Atmos intends to assist Woodward in increasing its natural gas customer base and in exploring the opportunities for electricity marketing as an added service for Atmos' growing customer base. In its acquisition of ANG's Missouri gas distribution service area, Atmos has also potentially increased its nonregulated subsidiary's natural gas customer base. How much of the $3.6 merger premium was paid to potentially improve the financial prospects of Woodward is not known, but whatever this amount is, it should not be borne by ANG's Missouri regulated gas customers.

Q. Is there another example where Atmos' nonregulated investments may benefit financially from the acquisition of ANG's Missouri gas assets?

A. Yes. At page 17 of its 1999 Annual Report to Shareholders (Annual Report), Atmos describes how its nonregulated subsidiary, Atmos Energy Services, Inc. (AESI) is preparing to market new products and services to Atmos' existing (mostly regulated) customer base:

> AESI is preparing to market new retail products and services to Atmos' approximately one million existing natural gas customers. AESI is evaluating a number of products and services to offer to customers by developing partnerships with experienced mass marketers. The Company conducted a pilot offering of a utility security product during 1999, and received a very favorable response to the offering. In addition, when unbundling does occur, AESI will offer customers the natural gas commodity, and possibly electricity as well. (emphasis added)

It is reasonable to conclude that Atmos considered these potential financial benefits to its nonregulated investments in determining the amount of money it was willing to pay to acquire ANG's regulated gas customers.

Q. Are there other benefits of the acquisition which may accrue to the benefit of Atmos' shareholders and not to ANG's Missouri ratepayers?

A. Yes. On page 5 of its 1999 Annual Report, Atmos states:

> Growth through acquisitions is a key component of Atmos' strategy for increasing earnings and building value for the Company. As a larger company, Atmos will have an even greater competitive advantage as the natural gas industry continues toward unbundling and becomes more competitive.

The Staff asserts that "competitive advantage" in a competitive environment is clearly a shareholder benefit, not a ratepayer or customer benefit. The cost to acquire this benefit (Atmos' $3.6 million acquisition premium) should be borne by the entity who is the clear intended beneficiary of the transaction - Atmos' shareholders.

Q. When Atmos acquires existing regulated gas distribution companies, does it acquire any intangible assets in addition to the actual gas distribution assets?

A. Yes. In its 1999 Annual Report, Atmos indicates that it has a policy of retaining local brand identities. For example, the brand name of a local utility that has operated in its service are for many years is often well respected and trusted by the community. This "respect" and "trust" have an intangible value and can be considered an asset of the utility similar to other utility assets. When a utility that has developed a respected brand name is acquired in a merger or acquisition, it is very likely that the sale price that the selling utility demanded was higher than that which a utility without such a valued brand name could demand. However, the amount of the purchase price attributable to the purchase of the brand name does not provide any value to the existing regulated customer base. This amount of the purchase price (or acquisition premium) can not be allocated to the regulated utility because it is not an asset that is "used and useful" in providing utility service.

Q. Are there any incentives for a utility seeking recovery of a merger premium in rates to objectively allocate the merger premium costs between its regulated and nonregulated assets?

A. No. Although most or all of a merger premium may be attributable to a utility's nonregulated businesses, there is no incentive for an acquiring utility to allocate any portion of the premium to the acquired nonregulated assets. The incentive is to allocate the entire premium to the acquired regulated businesses so that the premium may receive rate recognition and the cost is borne by captive regulated ratepayers.

Q. Would recovery of acquisition adjustments above-the-line by utilities increase rates for customers?

A. Yes. If, as is the case here, the acquisition adjustment is positive (i.e., purchase price exceeds net book value of the assets acquired), customer rates would increase. Increases in utility rates that result from a merger or acquisition transaction are inherently detrimental.

Q. Shouldn't the amount of customer benefits (expense savings and revenue enhancements) achieved as a result of a merger or acquisition be considered when evaluating inclusion of an acquisition adjustment in customer rates?

A. While utilities have argued that point in the past, the Staff does not agree that the potential existence of customer benefits from a merger or acquisition transaction is relevant to ratemaking policy on acquisition adjustments.

Q. Please explain.

A. Expense reductions and revenue enhancements affecting above-the-line utility financial results are directly related to the provision of service to customers and should be considered when setting customer rates. Acquisition adjustments, as previously discussed, are not directly or solely determined through an examination of customer benefits, and may be materially impacted by a purchaser's evaluation of non-regulated factors and benefits. For this reason, any special ratemaking consideration granted by the Commission to utilities undergoing mergers and acquisitions should focus on treatment of merger savings, and not on recovery of acquisition adjustments or other merger costs. In addition, rate recovery of an acquisition adjustment is a "hard" or actual cost. The benefit of acquisition savings is a "soft" benefit that can range from being speculative at worst to uncertain at best.

Q. Are you suggesting that it would be appropriate for the Commission to flow all benefits of an acquisition transaction to ratepayers, while charging all merger costs to utility shareholders?

A. No. Since merger and acquisitions have the potential to be beneficial to ratepayers, utilities should be given some opportunity to retain a portion of the benefits derived from such transactions. There are two fundamental ways of accomplishing this: 1) through regulatory lag, and 2) through a sharing of savings between customers and shareholders.

"Regulatory lag" is the passage of time between when a utility experiences a change in its cost of service and when that change is actually reflected in the utility's rates. In this context, under current regulatory practices in Missouri, utilities such as Atmos will have the opportunity to retain achieved non-gas cost merger savings for a period of time before they would be required to pass on those savings to customers through a reduction in rates. The impact on earnings of those retained savings would in essence give the utilities some "return" on its acquisition investment.

A proposal to "share" merger savings in a rate proceeding would allow utilities a means of retaining a reasonable portion of achieved merger savings rather than passing all savings to customers in entirety.

Q. Has Atmos used regulatory lag as a cost recovery mechanism in recovering its costs to acquire United Cities?

A. Yes. In its SEC Form 10-K filed on December 22, 1997, Atmos described how 635 employee positions will be eliminated after the merger.

> The United Cities Division will be structured like other divisions of Atmos. To achieve this structure, approximately 560 utility positions in the United Cities Division will be eliminated by September 1998. An additional 75 Atmos positions will be eliminated as part of the integration, resulting in approximately 635 total position reductions in the combined company by September 1998.

Because United Cities' gas utility rates currently include these payroll costs, the current rate revenues designed to cover the higher pre-merger payroll expense are being used to offset Atmos' costs to acquire United Cities. Until United Cities' utility rates are changed to reflect the lower number of employees, Atmos will continue to use the mechanism of regulatory lag to recover its costs to acquire ANG.

Deferred Tax Issue

Q. What condition related to the deferred taxes detriment is the Staff recommending be placed on any approval of this transaction by the Commission?

A. The Staff recommends that the Commission impose the requirement that Atmos will agree to hold ANG's Missouri ratepayers harmless from any increase in rate base caused by the loss of ANG's accumulated deferred income tax reserve. The Commission should require Atmos to agree to use an additional offset to rate base in any Atmos filing for a general increase in non-gas rates in Missouri completed in the next 10 years to compensate for rate base deductions that have been eliminated by Atmos' acquisition of ANG's Missouri gas assets. The amount of the offset for the first year shall be $3,218,780 (ANG's Missouri jurisdictional accumulated deferred income taxes at December 31, 1999) amortized ratably over a 10-year period. In addition, Atmos should be ordered to acquire and maintain all plant vintage and other records from SWEN that are necessary for an accurate accounting in its next rate case of ANG's jurisdictional amount of deferred income taxes at December 31, 1999.

Q. Please describe what is represented by the term "accumulated deferred income taxes."

A. A utility company uses an accelerated tax depreciation deduction to calculate taxable income. For accounting and ratemaking purposes, however, the utility uses straight line depreciation to calculate book net income. The dollar difference between the accelerated tax depreciation used to arrive at taxable income and the straight line book depreciation used in the calculation of net income each year is referred to as a book/tax timing difference. The annual amount of the book/tax timing difference times the current tax rate is the amount of deferred income taxes added to or subtracted from the accumulated deferred tax reserve each year. The following example will help illustrate the concept behind accumulated deferred income taxes:

> A utility consists of one asset costing $1,000 and placed in service in 1995. For tax purposes, the equipment is depreciated over five years using accelerated depreciation and for book, the equipment is depreciated ratably on a straight-line basis over its estimated useful life of 10 years. Assuming the corporate tax rate remains constant, the following table shows the calculation of the deferred tax reserve.

	Depreciation				**Rate Base Offset**
Year	**Tax**	**Book**	**Difference**	**Tax Rate**	**DeferredTax Reserve**
1995	$200	$100	$100	35%	$35
1996	$200	$100	$100	35%	$70
1997	$200	$100	$100	35%	$105
1998	$200	$100	$100	35%	$140
1999	$200	$100	$100	35%	$175
2000	$0	$100	($100)	35%	$140

2001	$0	$100	($100)	35%	$105
2002	$0	$100	($100)	35%	$70
2003	$0	$100	($100)	35%	$35
2004	$0	$100	($100)	35%	$0

This example shows that as of the end of 1997, the company collected $105 more in utility rates then it paid to the IRS. If the utility filed a rate case with a test year ending in December 1997, its rate base would be reduced by $105 to reflect that the ratepayers have supplied these funds (prepaid future income tax payments).

Q. Please explain why accumulated deferred income taxes are treated as a reduction from a utility's rate base.

A. Most state regulatory commissions treat accumulated deferred income taxes as a deferred liability which, in theory, the utility can use in the present to invest in property included in the rate base. If this portion of the rate base is essentially cost free, customers should not pay for it. Thus, the Commission requires the net book cost of the utility company's assets to be reduced by the amount of accumulated deferred income taxes under the theory that the customers should get the benefit of the deferred liability, rather than the company.

Q. Why will ANG's deferred income taxes be eliminated as a result of its sale to Atmos?

A. When a merger or acquisition is treated as a taxable asset sale, the deferred income taxes are in essence paid to the U.S. Treasury in the calculation of the amount of gain on the sale of the assets. This recognition causes the deferred taxes to be eliminated from the utility's books and the assets receive a brand new tax basis.

Q. What is the current amount of accumulated deferred income taxes on the books of ANG?

A. According to the Company's response to Staff Data Request No. 11, ANG's estimated total company accumulated deferred income taxes at December 31, 1999, is $4,943,603. The Missouri jurisdictional portion of this amount, using the Company's current plant in service allocation factor is $3,218,780.

Shortly before the filing of this testimony, the Staff learned from ANG that the amount of deferred income taxes provided to the Staff included the deferred taxes related to the acquisition adjustment recorded by SWEN when it acquired ANG in 1988. Since the acquisition adjustment was not included in ANG's cost of service, the deferred taxes related to the acquisition adjustment should not be included in the deferred tax offset to rate base. If ANG can provide plant records and other documentation showing that the accumulated deferred tax balance referenced above includes the deferred taxes related to the acquisition adjustment, and provide a reasonable method to separate these two amounts, then the Staff would be willing to adjust the $3,218,780 beginning amount of ANG's "lost" deferred taxes used as a rate base offset in ANG's future rate cases.

Q. What ratemaking treatment of ANG's accumulated deferred income taxes does the Staff propose will "cure" the detriment of the elimination of these deferred taxes to Missouri ratepayers?

A. The Staff proposes that ANG's Missouri jurisdictional December 31, 1999, balance of accumulated deferred income taxes be retained for ratemaking purposes in Atmos Energy's future rate cases for the former ANG's gas properties. This deferred income tax amount will be used to reduce ANG's rate base and will be amortized ratably over a 10-year period beginning at the date of closing.

Q. Was this concern about the loss of the deferred taxes offset to rate base an issue in a previous utility acquisition case in Missouri?

A. Yes. Case No. GM-94-40 was a joint application of Western Resources Inc. and Southern Union Company for a Commission order authorizing the sale of Western Resources' Missouri gas properties to Southern Union. This transaction was treated as a taxable asset acquisition by Southern Union. To prevent Missouri ratepayers from losing the benefits of the Western Resources' deferred taxes, the Staff proposed a reduction in rate base equal to the deferred taxes eliminated as a condition for recommending approval of Southern Union's acquisition. Southern Union agreed to this treatment in the Unanimous Stipulation and Agreement which was subsequently approved by the Commission.

Paragraph 8 of the Unanimous Stipulation and Agreement reads:

> Southern Union agrees to use an additional offset to rate base in any Southern Union filing for a general increase in non-gas rates in Missouri completed in the next ten years to compensate for rate base deductions that have been eliminated by this transaction. The amount of the offset for the first year shall be $30.0 million. The amount shall reduce by $3.0 million per year on each anniversary date of the closing of the subject transaction.

Q. How did the Staff arrive at a 10-year period to amortize the accumulated deferred tax reserve?

A. The 10-year amortization period for the reinstated accumulated deferred income taxes in Case No. GM-94-40 was agreed to by the parties to the case. It was an attempt to match the reinstated deferred taxes and the future actual current deferred taxes with the amount of deferred taxes that would have existed if the acquisition did not take place. The Staff is willing to work with Atmos if the Company believes a different amortization period would be more theoretically correct.

Excess Pension Asset Issue

Q. What condition related to the pension asset detriment is the Staff recommending be placed on any approval of this transaction by the Commission?

A. The Staff recommends that the Commission, as a condition to approving this transaction, require SWEN to transfer a pro rata share of the ANG Missouri employees' excess pension assets in the SWEN pension fund to the Atmos pension fund.

Q. Please summarize the Staff's position on this issue.

A. As described earlier, ANG is a division of Arkansas Western Gas Company (AWG), and AWG is a subsidiary of SWEN. SWEN has one pension plan which covers all of its eligible SWEN employees. The SWEN pension plan (as most utility pension plans) is significantly overfunded. That is, the market value of the pension funds, exceeds the projected benefit obligation ("PBO"), based on actuarial reports calculated in accordance with Financial Accounting Standard 87, *Employers' Accounting for Pensions* (FAS 87). For ratepayers, whose contributions have led to this overfunded pension plan, the over-funding creates a reduction in the pension expense a utility would otherwise need to recover in rates. ANG's current gas rates reflect a level of pension expense that was calculated with the full benefit of ANG's allocated share of excess pension assets in the SWEN pension fund. In ANG's last rate case, the Company did not propose any adjustment to ANG's pension expense that removed the benefit of a pro rata share of excess plan assets then currently in the fund. Therefore, any attempt now by SWEN to transfer less than ANG's pro rata share of excess pension assets in the SWEN pension plan constitutes a detriment to ANG's Missouri ratepayers. Staff accounting witness Graham A. Vesely is the primary accounting witness on this issue. He provides a complete description of the Staff's position in his rebuttal testimony in this case.

Q. Mr. Hyneman, were you the Staff witness who sponsored the Staff adjustment to ANG's pension expense in its last rate case, No. GR-97-272?

A. Yes, I was.

Q. Please describe how the level of pension expense in ANG's current rates was calculated.

A. The level of pension expense in ANG's current rates was calculated with the benefit of $10,675,440 in excess pension plan assets. In Case No. GR-97-272, the Staff accepted the Company's proposed level of pension expense with the exception of how the calculation of gains and losses should be reflected. It is important to note that in the rate case, even SWEN proposed that ANG's employees receive their pro rata share of the benefit of the excess pension assets. Schedule 2, attached to this testimony, is the portion of my direct testimony in Case No. GR-97-272 which shows the calculation of ANG's pension expense based on an allocated portion of SWEN's 1996 pension expense. Schedule 3 is a calculation from SWEN's 1996 pension actuary report, which shows the amount of excess pension assets as of January 1, 1996. (assets of $49,570,360 less PBO of $38,894,920)

Q. What is the Company's rationale for not transferring any of the excess pension plan assets to Atmos' pension plan?

A. It is the Staff's understanding that the Company believes that, since the SWEN plan was significantly more overfunded then the ANG plan on the date the ANG plan was merged into the SWEN plan, it follows that no excess plan assets should be attributed to the ANG plan.

Q. Is the fact that the SWEN pension plan was more overfunded than the ANG plan when it was merged over seven years ago relevant to the appropriate allocation of pension assets and liabilities to the Atmos pension plan in this case?

A. No. The issue that Staff is addressing in this case is ratepayer detriment. It is clear that if SWEN does not transfer a pro rata share of the amount of excess pension assets in its pension plan, then the Missouri ratepayers will lose the benefit (which they have today) of these assets in the calculation of annual pension expense.

Q. Is there an issue in this Application that, while not currently considered a detriment, is a concern of the Staff?

A. Yes. Unlike its pension plan which is consolidated with the SWEN pension plan, ANG has its own Employee Medical, Dental and Life Plan (commonly referred to as the Other Postretirement Benefits Plan or OPEB) which provides medical, dental and life insurance benefits to retirees. The Staff understands that the only allocation of the ANG OPEB plan assets is between the existing Arkansas ANG employees and the Missouri ANG employees who will be transferred to Atmos. ANG began funding this plan when OPEB expense was included in ANG's non-gas rates on an accrual basis (as opposed to a cash basis) in ANG last Missouri rate case, No. GR-97-272. According to the Company's response to Office of the Public Counsel (OPC) Data Request No. 20, both SWEN and ANG's actuaries are currently performing the detailed calculations relating to the plan's liabilities and split of plan assets. While the Staff does not anticipate that the allocation of the OPEB funds to Atmos will be an issue, the Staff would expect Atmos to obtain from ANG and provide to the Staff in ANG's next Missouri rate case, all the documentation necessary to fully account for the disposition of the funds in ANG's OPEB plan at the date of acquisition by Atmos.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the Joint Application of Atmos Energy Corporation and Arkansas Western Gas Company, d/b/a Associated Natural Gas Company, for an order authorizing the sale and transfer of certain assets of Associated Natural Gas Company located in Missouri to Atmos Energy Corporation and either authorizing the transfer of existing certificates of public convenience and necessity or granting a new certificate of public convenience and necessity to Atmos Energy Corporation in conjunction with same.	)	CASE NO. GM-2000-312

AFFIDAVIT OF CHARLES R. HYNEMAN

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Charles R. Hyneman, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 22 pages to be presented in the above case; that the answers in the foregoing Rebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Chas R. Hy

Charles R. Hyneman

Subscribed and sworn to before me this 29th day of February, 2000.

Toni M Willmeno

Notary Public, State of Missouri
My Commission Expires ____________

TONI M. WILLMENO NOTARY SEAL NOTARY PUBLIC STATE OF MISSOURI

TONI M. WILLMENO
NOTARY PUBLIC STATE OF MISSOURI
COUNTY OF CALLAWAY
My Commission Expires June 24, 2000

Charles R. Hyneman

Schedule of Testimony Filings

Case No.	Company
TR-93-181	United Telephone Company of Missouri
ER-94-163	St. Joseph Light & Power Company
HR-94-177	St. Joseph Light & Power Company
GR-95-160	United Cities Gas Company
EM-96-149	Union Electric Merger with CIPSCO, Inc.
GR-96-285	Missouri Gas Energy
GR-97-272	Associated Natural Gas Company
ER-97-394	UtiliCorp United, Inc.
GR-98-140	Missouri Gas Energy
EM-97-515	Western Resources, Inc. Acquisition of Kansas City Power & Light Co.
GO-99-258	Missouri Gas Energy

a pay-as-you-go basis.

Q. Please explain how pension expense is calculated under FAS 87.

A. The method of calculating FAS 87 pension expense is very similar to the calculation of FAS 106 OPEB expense. The components included in the calculation of pension expense for 1996 as determined by the Company's actuary are shown below:

Component	Amount	Description
Service Cost	$1,520,021	Expense caused by the increase in future pension benefits payable (projected benefit obligation) to employees because of their services rendered during the current year.
Interest Cost	$2,849,974	Because a pension is deferred compensation, there is a time value of money factor. Interest accrues each year on the estimated amount of future pension benefits payable.
Expected Return	($4,380,759)	An adjustment to pension expense based on the expected return on pension plan assets during the year.
Amortization of Transition Asset and Prior Service Cost	($140,634)	Amortization of transition asset as of the adoption date of FAS 87 and the impact of plan amendments related to prior service.

Amortization of Unrecognized Net Gain	($100,404)	Amortization of net gain balance resulting from pension plan assumption changes and excess of actual returns on pension plan assets over expected returns.
Pension Expense	($251,802)	

As shown above, the increase in pension expense from service cost and interest cost is offset by the decrease in pension expense from the expected return on plan assets, and the sum of the amortizations of the transition asset, prior service cost and unrecognized net gain. The net result is a negative pension expense or pension credit.

Q. Is all of the $251,802 pension credit related to ANG's operations?

A. No. Unlike postretirement benefits, SWN only has one pension plan. All of the eligible employees of SWN, Arkansas Western Gas Company, and the other affiliated companies are included in the SWN pension plan. In the Company's rate filing, ANG is being allocated approximately 26 percent or $65,469 of the pension credit.

Q. Please describe the amortization of gains and losses component of FAS 87 pension expense.

A. The unrecognized gain or loss balance is made up of asset gains and losses and liability gains and losses. An asset gain or loss occurs when the expected level of return on plan assets differs from the actual return on assets. For example, when the actual return is greater than the expected return, the excess amount is referred to as an asset gain and is included in an Unrecognized Net Gain or Loss account and combined with unrecognized

TABLE 1

NET PERIODIC PENSION COST

1. Service Cost with Interest to End of Year		$1,520,021
2. Interest Cost		
a. Projected Benefit Obligation at Beginning of Year	$38,894,920	
b. Discount Rate	7.50%	
c. Interest on Anticipated Benefit Payments	$67,145	
d. Interest Cost [(2a x 2b) – 2c]		2,849,974
3. Return on Plan Assets		
a. Market–related Value of Assets at Beginning of Year	$49,570,360	
b. Long–term Expected Rate of Return	9.00%	
c. Expected Return on Benefit Payments and Contributions	$80,573	
d. Expected Return [(3a x 3b) – 3c]*		(4,380,759)
4. Net Amortization and Deferral*		(241,038)
5. Net Periodic Pension Cost (1+2+3+4)		($251,802)

* For year–end financial reporting purposes, compensating adjustments will be made in items 3 and 4 to recognize the return on plan assets through the end of the year.