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February 8, 2002

Mr. Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102

FILED[3]
FEB 0 8 2002
Missouri Public Service Commission

RE: Case No. GM-2002-295

Dear Mr. Roberts:

Enclosed for filing in the above-captioned case are an original and eight (8) conformed copies of a **STAFF RECOMMENDATION.**

This filing has been mailed or hand-delivered this date to all counsel of record.

Thank you for your attention to this matter.

Sincerely yours,

Thomas R. Schwarz, Jr.

Thomas R. Schwarz, Jr.
Deputy General Counsel
(573) 751-5239
(573) 751-9285 (Fax)

TRS:sw
Enclosure
cc: Counsel of Record

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

FILED[3]

FEB 0 8 2002

Missouri Public
Service Commission

In the Matter of the Application of Atmos Energy Corporation for an Order Authorizing it to Merge with Mississippi Valley Gas Company.	))))	Case No. GM-2002-295

STAFF RECOMMENDATION

COMES NOW the Staff of the Public Service Commission of Missouri and for its recommendation in this case states:

1. Atmos Energy Corporation operates natural gas distribution systems in three separate service areas in Missouri, doing business as United Cities Gas Company, Greeley Gas Company and Atmos Energy.

2. On December 20, 2001, Atmos filed an application with the Commission to for authorization to merge with Mississippi Valley Gas Company, a utility that operates in the State of Mississippi.

3. Staff has reviewed the application, and the circumstances of Atmos' Missouri operations, suggests that the proposed merger will not be detrimental to the public interest, and recommends that if the Commission grant the authorization sought in the application, it does so with conditions. See the formal Staff recommendation attached as Attachment A.

WHEREFORE, Staff recommends that the Commission issue its order in this case consistent with the recommendations made in Attachment A.

1

Respectfully submitted,

DANA K. JOYCE
General Counsel

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record as shown on the attached service list this 8th day of February, 2002.

Thomas R. Schwarz, Jr.

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. GM-2002-295, Atmos Energy Corporation

FROM: Roberta McKiddy, Financial Analysis Department RM
Lisa Kremer, Engineering and Management Services Department LK
James Russo, Energy–Tariff/Rate Design Department JR

R.D. Schallenberg 2/7/02 — Utility Services Division/Date
Thomas R. Schwarz, Jr. 2/8/02 — General Counsel's Office/Date

SUBJECT: Staff Recommendation for Atmos Energy Corporation's Request for Authorization to Merge with Mississippi Valley Gas Company

DATE: February 7, 2002

Background

On December 20, 2001, Atmos Energy Corporation ("Atmos" or "ATO") filed an Application with the Missouri Public Service Commission ("Commission") requesting authorization to merge with Mississippi Valley Gas Company ("MVG"). Atmos states the following in its Application:

> Pursuant to an Agreement And Plan of Merger And Reorganization between Atmos and MVG and the Shareholders Names on the Signature Pages Hereto, dated September 21, 2001 (the "Agreement"), which is attached hereto as Appendix 2 and incorporated herein by reference, Atmos and MVG have agreed upon the terms and conditions under which MVG would merge with and into Atmos, with Atmos being the surviving corporation. ("the Merger") Following the Merger, Atmos will operate the business formerly conducted by MVG as a division of Atmos Energy Corporation in the State of Mississippi. The manner of providing natural gas services to customers in MVG's service area in Mississippi will remain largely unchanged. In addition, Atmos' various divisions in Missouri will remain unaffected by this transaction.
>
> ...The proposed transaction will not impact any of the tax revenues of the Missouri political subdivisions in which any structures, facilities, or equipment of Atmos are located.

Atmos is a corporation organized and existing under the laws of the state of Texas and the Commonwealth of Virginia with its principal place of business located in Three Lincoln Center, Suite 1800, 5430 LBJ Freeway, Dallas, Texas 75240. Atmos is a public utility involved in the distribution, transportation and sale of natural gas in Missouri, Texas, Louisiana, Kentucky, Colorado, Kansas, Illinois, Iowa, Tennessee, Georgia and Virginia. Atmos provides natural gas on a retail basis to approximately 1.4 million customers.

Attachment A

MVG is a corporation duly organized and existing under the laws of the State of Mississippi having its principal office and place of business at 711 West Capital Street, Jackson, Mississippi 39207. MVG is engaged in the transmission and distribution of natural gas and subject to the jurisdiction of the Mississippi Public Service Commission. MVG serves approximately 261,500 customers in the transmission and distribution of natural gas.

Comments

Atmos has proposed to merge with and into MVG with Atmos being the surviving corporation. Atmos and MVG have agreed to a purchase price of $150,000,000 less certain adjustments outlined on page 2 of the Stock Purchase Agreement dated September 21, 2001. Fifty percent (50%) of the purchase price will be cash and fifty percent (50%) or $75 million will be shares of the common stock of Atmos. Atmos has also agreed to assume approximately $45 million of MVG's outstanding debt as part of the transaction. Company states in its response to Office of Public Counsel's Data Request No. 2014, that the cash portion of this purchase price will be funded by permanent long-term debt financing with the exact amount, interest rate and maturity to be determined by conditions prevailing in the capital markets at the time of issuance.

Staff reviewed the proposed merger application and exhibits along with Company data responses, which included a number of credit agency reports and securities analyst reports related to this transaction. Overall, credit agencies and securities analysts view this transaction positively. Standard and Poor's ("S&P") states the following in its report dated September 24, 2001:

> ...Standard and Poor's believes that Atmos' credit quality will not be affected by this acquisition due to the company's adequate financial measures, the method of the acquisition (cash & stock), the expected future economies of scale, additional stable cash flows and the company's continued commitment to improve its financial measures.
>
> ...The company has high debt-to-total capital ratio near 60% of the "A-" rating, but is currently improving the ratio by issuing additional equity, lowering the dividend payout ratio, and funding capital expenditures internally. Funds from operations to interest expense is adequate at 4.0 times. Approximately 30% of Atmos' customer base is not covered by weather-normalization clauses or weather insurance. Therefore, Atmos' revenue are exposed to weather-related risk. This exposure may provide an upside potential for earnings and cash flow, but may increase revenue volatility.
>
> The stable outlook reflects Atmos' intention to lower the total debt-to-total capital ratio to 50% or less by 2004, by lowering the dividend payout resulting in increases to retained earnings. However, Atmos also intends to grow both the regulated and nonregulated businesses primarily through acquisitions, to meet its earnings growth target of 8% to 10%. Standard and Poor's believes that management will be challenged to meet both objectives, while utilizing high levels of debt to acquire assets.

Moody's Investors Services also views this transaction positively. Moody's states the following in its September 27, 2001 report:

> The rating outlook is stable. In maintaining our A3 rating, we expect Atmos to derive some administrative and logistical synergies from the MVG acquisition that would be phased in over time. Half of the financing will be in the form of common stock, which will help it to balance its capital structure.

Likewise, A.G. Edwards views the transaction in a positive light. A.G. Edwards states the following in its November 21, 2001 report:

> ATO has been one of the more acquisitive distributors in the nation over the last several years, including two sizable acquisitions within the last 18 months. By pursuing this aggressive acquisition strategy, ATO is continually challenged to successfully absorb new entities while holding the line on operating costs. We believe that ATO will continue to seek new expansion opportunities going forward, and given its positive track record, should likely be successful in its pursuits.
>
> ...We continue to believe that the MVG acquisition fits well with ATO's strategic expansion plans in the region. In addition, given ATO's solid history of absorbing entities into its systems and effectively cutting cost, we look for the acquisition to prove accretive to earnings in its first full year of operations.

In addition to reviewing these reports, Staff reviewed the capital structures of Atmos and MVG on both a pre- and post-merger basis. As of September 30, 2001, Atmos reported a capital structure consisting of 38.97 percent common equity, 13.43 percent short-term debt and 47.60 percent long-term debt. On a pro forma basis as of September 30, 2002, Atmos reported a capital structure consisting of 39.95 percent common equity, 11.86 percent short-term debt and 48.18 percent long-term debt.

MVG reported a capital structure consisting of 59.77 percent equity, 7.39 percent short-term debt, and 32.84 percent long-term debt as of September 30, 2001. On a pro forma basis as of September 30, 2002, MVG reported a capital structure of 61.79 percent equity, 7.13 percent short-term debt, and 31.08 percent long-term debt.

On a consolidated basis, Staff has determined Atmos' capital structure will consist of 40.71 percent equity, 12.93 percent short-term debt and 46.36 percent long-term debt as of September 31, 2001. On a consolidated pro forma basis, Staff has determined Atmos' capital structure will consist of 41.68 percent equity, 11.49 percent short-term debt and 46.83 percent long-term debt.

Atmos has been assigned a corporate credit rating by Standard and Poor's of "A-" as of January 2, 2002. Under an "A" credit rating, Standard and Poor's suggests a company strive to achieve a total debt to total capital ratio between 42.15 percent and 56.10 percent. Atmos currently has a total debt to total capital ratio of 61.03 percent. Despite this high total debt to total capital ratio, Standard and Poor's has assigned a "stable" outlook to Atmos. Staff interprets this to mean that Standard and Poor's believes Atmos will strive to reduce its total debt to total capital ratio to 50 percent or less by 2004 while maintaining its current "A-" credit rating.

Staff also reviewed Atmos' Agreement and Plan of Merger and Reorganization. Atmos states as part of its Agreement and Plan of Merger and Reorganization that it has "no plan or intention to sell, exchange, transfer or otherwise dispose of the assets acquired from the Company, except for (i) dispositions made in the ordinary course of business, and (ii) transfers described in Section 368(a)(2)(C) of the Internal Revenue Code of 1986 (see Exhibit H)."

Based on the evidence presented in this case, Staff believes the merger as proposed by Atmos, will not be detrimental to the Missouri ratepayers. However, Staff has identified several areas of concern.

Customer Service Performance Measures and Reporting Requirements

The first area of concern is customer service. The prefiled rebuttal testimony filed by Staff in Case No. GM-2000-312 (Atmos acquisition of the former ANG operations) outlined the importance of customer service performance measures, in general, as a managerial control tool for the vital customer service function and in particular, as a means of helping to ensure, in merger or acquisition cases, that a degradation of certain customer service activities does not occur in the post-transaction environment. In that case, Staff took the position that, as a condition precedent to Commission approval, the parties should be required to reach an agreement that establishes reasonable performance measures, against which Atmos will be measured, in order to help ensure that there will be no degradation in customer service. Staff noted in testimony that the establishment of two such performance measures, the Abandoned Call Rate ("ACR") and the Average Speed of Answer ("ASA"), became an integral aspect of agreements in two recent merger cases that received Commission approval (Case Nos. EM-97-515, Western Resources, Inc./Kansas City Power and Light Company and GM-2000-43, Southern Union Company/Pennsylvania Enterprises, Inc.).

In addition to specifying measures for ACR and ACA, a number of additional requirements designed to maintain a consistent level of customer service were identified. In particular, it was proposed that Atmos provide quarterly reports of its performance against the established measure to both Staff and OPC. It was further proposed that Atmos provide Staff and OPC with a written explanation of any unfavorable variances against the measures. These customer service provisions were similar to those previously approved by the Commission in the aforementioned merger cases.

Staff believes these customer service performance measures remain important in the context of this merger Application. As such, Staff proposes that the Company agree to adopt and extend all customer service provisions and measurements including all reporting requirements for a period of one additional year through calendar year 2004, as specified on pages 2 through 7 of the Unanimous Stipulation and Agreement in Case No. GM-2000-312. Staff will also continue to provide reports to the Company through the year 2004, as specified in the Unanimous Stipulation and Agreement in Case No. GM-2000-312. At that time, the Staff and Company may petition the Commission to continue or modify any of the reporting requirements as deemed appropriate.

Surveillance Data Reporting

The second area of concern is surveillance data reporting. The Commission has the authority to obtain surveillance data from the public utilities within the jurisdiction of the Commission pursuant to Section 393.140(9) RSMo 2000 for electrical, gas, water and sewer corporations and Section 392.210.1 for telecommunications companies.

Atmos currently submits surveillance data reports to the Financial Analysis Department of the Commission on behalf of several of its operating units. Atmos first began submitting monthly surveillance data on behalf of its United Cities Gas ("UCG") operating unit in approximately

1990. Along with the UCG data, Atmos submitted total company data for Atmos on a consolidated basis. Beginning June 2000, Atmos began submitting UCG data consolidated with financial data specific to its newly acquired Associated Natural Gas Company ("ANG") although UCG and ANG continued to function as separate operating units. Prior to its acquisition by Atmos, ANG submitted surveillance data information for its Missouri operations for approximately ten (10) years. Staff understands that Atmos has not, to date, filed a request with the Commission requesting authority to combine these operations under a single certificate or set of tariffs. As such, Staff contends that Atmos should be required to submit UCG and ANG surveillance data as separate submissions until such time authority is granted by this Commission to combine the two units into one operating unit. Atmos also submits separate surveillance data reports on a quarterly basis for its Greeley Gas operating unit.

Surveillance data reporting is a tool used by the Commission Staff to monitor the finances of public utilities for over-earnings. The Commission's Financial Analysis Department tracks and analyzes financial information submitted by public utilities within the jurisdiction of the Commission through the assistance of a Surveillance Reporting and Tracking System (SURTS). There are currently 24 calculations performed by the Commission's Financial Analysis Department based on the financial information submitted by selected public utilities within the jurisdiction of the Commission. Some of the key calculations performed include: (1) return on 12-month ended rate base based on Missouri jurisdictional operations; (2) return on average common equity; (3) pre-tax interest coverage; (4) capital structure components as a percentage of total capital and (5) Missouri jurisdictional revenues (excess)/deficit.

Staff believes it is important for Atmos to continue the submission of surveillance data reports for two reasons: (1) to allow Staff an opportunity to monitor the earnings of Atmos and its operating units to ensure protection of Missouri ratepayers from any possible over-earnings by the Company and (2) to provide Staff with data helpful in making a preliminary assessment of the effects of the pending merger of Atmos and MVG.

Tariff Compliance and Consolidation

The final area of concern is tariffs. Staff is concerned that the Company is not following its tariffs and has not consolidated the tariffs for their Missouri properties. Atmos indicated in their response to Staff Data Request No. 3501 in Case No. GM-2000-312 they intended to consolidate their tariffs for ANG and UCG within several months of the completion of the merger. To date, Atmos has not filed a request with the Commission requesting authority to combine the operations of UCG and ANG. The problem(s) of using the wrong tariff sheet and/or schedule, rule and regulation for the wrong district exists today.

To further explain the circumstances surrounding this concern, Staff offers the following evidence presented by Staff witness Thomas M. Imhoff in Case No. GM-2000-312:

> Q. Will the Company maintain two separate sets of tariffs for UCG and ANG properties indefinitely?
>
> A. No. In the Company's response to Staff Data Request No. 3501, the Company indicated plans to consolidate the tariffs within the next several months after the merger. During this time, the Company intends to work with the Staff to ensure that this process goes smoothly. Consolidating the tariffs of UCG and ANG would make the administration and operation of Atmos' property simpler and possibly more efficient. UCG and ANG tariffs

currently have different rates for customers requiring certain services that are not directly related to gas usage. Items such as bad check charges, line extensions, reconnects, etc. have rates associated with them that have been based upon costs that were developed from different utility companies. Therefore, the rates and charges which fall out after consolidating tariffs may result in rates much different than those contained in either UCG's or ANG's current tariff.

In the Staff's opinion, consolidating these tariffs should be handled only in the context of a rate case. This would ensure that all customers of the Company would have appropriate notification and an opportunity to express concerns or support for the consolidation of these tariffs. A rate case would also give the Staff, OPC, intervenors and any other interested party the opportunity to analyze any changes that may be proposed to effectuate consolidation of the tariffs.

It is Staff's understanding that Case No. GM-2000-312 proposed that Atmos purchase only the Missouri properties belonging to ANG whereby the remaining properties owned by ANG would continue to provide service in the state of Arkansas under the ANG name. As such, Atmos would be prohibited from using the ANG name in the operation of the Missouri properties purchased from ANG.

Conclusion

In conclusion, it is Staff's opinion, based on the evidence provided, that the transaction described in Atmos' Application will not be detrimental to the ratepayers of Missouri. However, the Staff encourages the Commission to impose certain conditions of approval to ensure the areas of concern raised by Staff are appropriately addressed in order to provide additional protection for Missouri ratepayers. Therefore, Staff recommends the Commission approve Atmos' Application with the following conditions:

1. That Atmos be ordered to adhere to the customer service performance measures and reporting requirements outlined in this Staff Recommendation through the year 2004.

2. That Atmos be ordered to submit surveillance data reports on a stand alone basis for its Missouri operating units, which include United Cities Gas Company, Associated Natural Gas Company on a monthly basis and Greeley Gas Company on a quarterly basis. In addition, Atmos should be ordered to submit total company data on a consolidated basis monthly in conjunction with its separate submittals for UCG and ANG.

3. That Atmos be ordered to comply with the tariffs filed with the Missouri Public Service Commission, or in the alternative, immediately file with the Commission a request for approval to consolidate the tariffs of UCG, Greeley and, those of ANG adopted by Atmos.

4. That nothing in the Commission's order shall be considered a finding by the Commission of the value of this transaction for rate making purposes, and that the Commission reserves the right to consider the rate making treatment to be afforded this transaction in any subsequent proceeding.

5. That the Commission's order shall not be deemed precedent for any future transaction even if the facts may be similar.

6. That any adverse financial effects of this acquisition shall be borne by Atmos stockholders and not by Missouri ratepayers.

7. That all records pertaining to these transactions shall be maintained at Atmos' headquarters and made available to the Staff as the Staff deems necessary.

8. That no finding be rendered that would bind any party to any cost allocation or ratemaking principle in any future case.

Attachment: Pro Forma Capitalization as of September 30, 2001 for Atmos Energy Corporation

cc: Director of Utility Operations Division
Director of Utility Services Division
General Counsel
Ron Bible, Manager of Financial Analysis
Warren Wood, Manager of Energy Department
Lisa Kremer, Manager of Engineering and Management Services Department
Douglas C. Walther, Senior Attorney for Atmos Energy Corporation
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Office of Public Counsel

Service List for
Case No. GM-2002-295
Revised: February 8, 2002 (SW)

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