MISSOURI PUBLIC SERVICE COMMISSION

REVENUE REQUIREMENT

COST OF SERVICE REPORT

ATMOS ENERGY CORPORATION

CASE NO. GR-2010-0192

Jefferson City, Missouri
June 4, 2010

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I. EXECUTIVE SUMMARY

A. Staff's Revenue Requirement Recommendation

The Staff has conducted a review of all cost of service components (capital structure and return on rate base, rate base, operating revenues and expenses) which comprise the revenue requirement of the Missouri Operations of Atmos Energy Corporation (Atmos or Company). This audit was in response to the Company's December 28, 2009 filing seeking to increase rates to recover approximately an additional $6.4 million annually. The Staff's recommended revenue requirement for Atmos, based on updated results through February 28, 2010 is approximately $4.8 million at the Staff's recommended 9.45 % mid-point rate of return on equity.

B. Impact of Staff's Revenue Requirement on Retail Rate Revenue

The impact of the Staff's recommended revenue requirement on each of Atmos' rate classes will be discussed in the Staff's rate design and class cost of service report that is to be filed on June 18, 2010. A portion of the Staff's general rate increase recommendation has already been passed on to Atmos' customers through the Infrastructure System Replacement Surcharge (ISRS). The Company is currently authorized by the Missouri Public Service Commission (Commission) to receive ISRS rates of approximately $1 million annually. Once rates ordered by the Commission in this proceeding become effective, the current ISRS rate surcharge will be reset to zero and the amounts formerly collected through the ISRS surcharge will then be part of Atmos' general retail (base) rates. When the rate increases associated with the Atmos ISRS are taken into account, the amount of the Staff's recommended incremental rate increase in this case would equal approximately $3.8 million (the Staff's revenue requirement recommendation in this case at mid-point of $4.8 million less $1 million of ISRS revenue).

II. BACKGROUND

The Missouri Operations of Atmos are part of the Kentucky/Mid-States and Colorado-Kansas Divisions of Atmos Energy Corporation, whose headquarters is in Dallas, Texas. The Missouri Operations of Atmos provide gas service to approximately 56,000 customers, in three districts included in parts of Northeast, Southeast and Western Missouri.

The Commission last authorized new rates for Atmos with an effective date of the April 1, 2007 in Case No. GR-2006-0387. In that case the Commission approved a stipulation and agreement that did not provide for a rate increase, but allowed Atmos to implement a new rate design and consolidate its service territory from seven to three operating districts.

III. TEST YEAR AND TRUE-UP RECOMMENDATION

Atmos filed its original rate request based on an historic test year ending June 30, 2009. However, several income statement adjustments proposed by Atmos reflected known or anticipated changes occurring, in many instances, several months beyond the end of the historic test year. Examples of such Company-proposed post test year changes included actual/expected wage increases; employee benefits cost changes, and anticipated loss of residential customers. No specific request for an update or a true-up of significant cost of service components was included in the Company's application.

On January 6, 2010, the Commission issued its *Order Directing Notice, Suspending Tariff, Setting Hearings, And Directing Filings* (Suspension Order). Among other things, the Commission in its Suspension Order directed that the parties shall file recommendations concerning the update period for known and measurable changes and for a true-up. On January 26, 2010, Atmos filed its Recommendation Regarding Test Year. In that pleading, Atmos recommended setting an update period for known and measurable changes through March 31, 2010, and stated that a True-Up Proceeding will not be required in this case. As a result of an agreement between Atmos, the Commission's Staff, the Office of the Public Counsel (OPC), Noranda, and the Missouri Department of Natural Resources, the update period was shortened to February 28, 2010 and the Company agreed to provide the necessary information update information by no later than April 15, 2010.

The Commission in its *Order Adopting Procedural Schedule With Modifications, Establishing Test Year, and Adopting Proposed Customer Notice* issued on February 16, 2010, established a test year ending June 30, 2009 and an update period through February 28, 2010. Also in this order, because Atmos represented that no true-up is required, and Atmos is the proponent of its rate case, the Commission did not reserve dates for a true-up hearing.

IV. MAJOR ISSUES

The Staff updated the major components of the Company’s revenue requirement through February 28, 2010. The major known differences between the Staff and the Company as reflected in their respective direct testimony filings include the following items along with their approximate dollar value:

Rate of Return – Issue Value ($700,000) The Company’s case reflects an 10.9% return on equity (ROE), while the Staff is recommending an ROE range from 8.95% to 9.95%, with a 9.45% mid-point ROE.

Rate Base – Issue Value ($300,000) The Staff has determined different levels of Case Working Capital and Accumulated Deferred Income Tax resulting in a lower amount of total rate base.

Reallocation of Corporate Costs – Issue Value ($100,000) The primary issue between the Company and Staff involves the Staff's proposal to reflect current fiscal year allocation factors and to reallocate certain corporate costs based on a different method than Atmos.

Employee Benefits – Issue Value ($500,000) This difference, in the Staff's opinion, is primarily the result of an accounting error, recorded in the Test Year, which overstated employee benefits expense, as well as an error included in the Company's calculation of revenue requirement.

Incentive Compensation - Issue Value ($300,000) Staff is proposing to eliminate incentive compensation, which is based on Atmos' earnings.

Supplement Executive Benefits Plan - Issue Value ($100,000) The Company has included this cost based on an actuarial analysis. The Staff believes the amount should reflect a three year average of the actual payments that were incurred.

Rate Case Expense - Issue Value ($100,000) In the Staff's opinion, this difference is the result of an accounting error, which overstated the amount of rate case expense reflected in Atmos' calculation of revenue requirement.

In addition to the items discussed above, there are two additional differences between the Staff and the Company resulting from the way in which the revenues related to the Infrastructure System Replacement Surcharge (ISRS) and a shift in the general service rate class are presented in the calculation of revenue requirement. Staff views these items as a difference in presentations rather than issues between itself and the Company.

The Company has annualized ISRS revenues and included this amount in the calculation of revenue requirement. This presentation has the effect of showing how much of an increase Atmos is recommending above the total rates, both permanent and interim ISRS that were being charged to ratepayers at the time of the Company's filing. Staff's presentation of revenue requirement eliminates the interim ISRS revenues, thus showing the entire increase in permanent/base rates as its calculation of the revenue requirement in this case. Therefore, the Staff's revenue requirement is approximately $394,000 higher than the Company's as a result of the difference in the treatment of ISRS rates.

Both the Company and the Staff are supporting a shift in the rate classes between small, medium and large general service. The Company has not shown this shift in the determination of revenue requirement at existing rates, while he Staff has made specific revenue adjustments to capture the expected loss in revenues in its calculation of revenue requirement. As a result the Staff's revenue requirement is approximately $472,000 higher than the Company's due to the difference in how the shift in the general service class is reflected.

Staff Expert Witness: (Section I, II, III and IV) Stephen M. Rackers

V. RATE OF RETURN

A. Summary

The Staff of the Commission's Financial Analysis Department recommends that the Commission authorize an overall rate of return (ROR) of 7.81 percent to 8.32 percent for Atmos Energy Corporation – Missouri Jurisdiction (Atmos). Staff's rate of return recommendation is based on a recommended return on common equity (ROE) of 8.95 percent to 9.95 percent, mid-point 9.45 percent, applied to Atmos Energy Corporation's February 28, 2010 common equity ratio of 50.97 percent. Staff's recommended ROE is driven by the results of its single-stage, constant-growth, discounted cash flow (DCF) analysis. Staff continues to believe that the DCF methodology is the most reliable method available for estimating a utility company's cost of common equity.

Staff also employed a Capital Asset Pricing Model (CAPM) as a test of reasonableness of its DCF result. Although the CAPM analysis resulted in a lower estimated cost of common equity than did Staff's DCF analysis, Staff did not adjust its ROE recommendation downward due to Staff's continued concerns about the reliability of CAPM results that estimate the current equity risk premium based on historical earned return spreads. Staff used Atmos Energy Corporation's actual consolidated capital structure, as of February 28, 2009, as the basis for Staff's ROR recommendation. This Atmos consolidated capital structure consists of 50.97 percent common equity, 47.50 percent long-term debt and 1.53 percent short-term debt. The use of a consolidated capital structure is consistent with Staff's past capital structure recommendations in Atmos rate cases. Based on Staff's review of Standard & Poor's (S&P) commentary on Atmos' credit rating, this is also consistent with how Atmos is viewed by at least this rating agency.

Additionally, it is presumed that investors base their decisions on the credit rating assigned to the consolidated capital structure, earnings per share and dividends declared at the consolidated level. Most importantly, all of Atmos' distribution operations are divisions, and it is Staff's understanding that divisions do not have a 'separate' and 'distinct' credit rating from the company within which they operate.

For the Commission's information, the short-term debt balance exceeded balances in Construction Work In Progress (CWIP). Since short-term debt is recognized as the primary funding source for CWIP, only the difference between the amount of short-term debt and CWIP is included in the capital structure. The difference was calculated by netting the twelve-month average (February 2009 to January 2010) of CWIP from the twelve-month average of short-term debt outstanding and produced 1.53 percent of short-term debt.

The schedules and attachments, referenced in this Section IV, can be found in Appendix 2 attached to this Report, with the attachments appearing first. Schedules 6 and 7 present the consolidated capital structure and associated capital ratios. Staff's embedded cost of long-term debt of 6.82 percent is based on information provided by Atmos in the Company's Cost of Service filing (Schedule 9, WP 9-2-1). Staff has prepared two attachments and 19 schedules that support its findings and recommendations for the cost-of-capital. The attachments contain explanations of both the DCF and the CAPM methodologies. These attachments are denoted as Attachments A and B, respectively, to this Report. The schedules present numerical support for the Staff's ROR recommendation and are numbered as Schedules 1 through 19.

B. Legal Principles of Rate of Return

Rate of return witnesses are mindful of the constitutional parameters that guide the determination of a fair and reasonable rate of return. These parameters were announced by the United States Supreme Court in two seminal cases, *Bluefield Water Works and Improvement Company v. Public Service Commission of West Virginia* (1923) (*Bluefield*) and *Federal Power*

Commission v. Hope Natural Gas Company (1944) (*Hope*).[1] The Court in *Bluefield* specifically stated:

> 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 return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.[2]

Similarly, the Court in *Hope* stated:

> The rate-making process, i.e., the fixing of "just and reasonable" rates, involves a balancing of the investor and the consumer interests. Thus we stated . . . that "regulation does not insure that the business shall produce net revenues." But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.[3]

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[1] ***Bluefield Water Works & Improv. Co. v. Pub. Serv. Comm'n of West Virginia,*** 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923); ***Fed. Power Comm'n v. Hope Nat. Gas Co.,*** 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943).
[2] ***Bluefield,*** *supra,* 262 U.S. at 692-93, 43 S.Ct. at 679, 67 L.Ed. at 1182-1183.
[3] ***Hope,*** *supra,* at 603 (citations omitted).

From these Court decisions, the following principles can be discerned:

(1) A fair return is consistent with that realized from an investment in comparable companies, that is, an investment of comparable risk.

(2) A fair return is sufficient to assure confidence in the utility's financial integrity.

(3) A fair return is one that allows the utility to attract capital.

(4) A fair return is consistent with the current opportunity costs of investment.

While the legal requirements announced in the *Hope* and *Bluefield* cases have not changed, it is important to recognize that the methodology used to estimate a reasonable rate of return has evolved considerably since these cases were decided over 60 years ago. In fact, two of the most commonly used models in making rate of return recommendations, the DCF model (as used in utility regulatory ratemaking proceedings) and the CAPM, did not become a part of mainstream finance until the 1960s. Likewise, capital markets are not confined to regional boundaries when determining the most efficient use of capital.

<u>DCF and CAPM Background</u>

The DCF model, as used in utility ratemaking, is referred to in mainstream finance as the dividend growth, Gordon growth, or dividend discount model (DDM). This model was introduced by Myron J. Gordon for use in cost of common-equity determinations in 1962.[4] The use of this model for stock valuation purposes had been introduced before this time.

The basis for the CAPM was provided in 1964 by William F. Sharpe, who received the Nobel Prize in 1990 for much of his work in producing this model.[5] The CAPM is frequently

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[4] Frank K. Reilly and Keith C. Brown, *Investment Analysis and Portfolio Management*, Fifth Edition, The Dryden Press, 1997, p. 438.

[5] Zvie Bodie, Alex Kane and Alan J. Marcus, *Essentials of Investments,* Richard D. Irwin, Inc. 1992, p. 11.

used by investment bankers to estimate the cost of capital for purposes of discounting future cash flows to determine an estimated present value of an enterprise.

<u>Why Experts Use the DCF Model to Determine a Reasonable ROE</u>

It is generally recognized that authorizing an allowed return on common equity based on a utility's cost of common equity is consistent with a fair rate of return. It is for this very reason that the DCF model is widely recognized as an appropriate model to use in arriving at a reasonable recommended ROE for a utility. The concept underlying the DCF model is to estimate a utility's cost-of-common-equity capital that reflects the current economic and capital market environment. For example, a company may achieve an earned return on common equity that is higher than its cost of common equity. This situation will tend to increase the share price. However, this does not mean that this past achieved return is the barometer for what would be a fair authorized return in the context of a rate case. It is the cost of capital that should be recognized as a fair authorized return.

The authorized return should provide a fair and reasonable return to the investors of the company, while ensuring that ratepayers do not support excessive earnings that could result from the utility's monopolistic powers. However, this fair and reasonable rate does not guarantee any particular level of return to the utility's shareholders.

Although neither the DCF model nor the CAPM were used for making rate-of-return-recommendations during the period in which the *Hope* and *Bluefield* decisions were made, state commissions throughout the country (including the Missouri Commission) have accepted these methodologies for purposes of estimating rates of return for utility ratemaking.

C. Economic Climate

According to a recent article in the Federal Reserve Board (Fed) Website (http://www.federalreserve.gov/newsevents/press/monetary/20100316a.htm), after its meeting on March 16, 2010, the Fed indicated as follows:

> While bank lending continues to contract, financial market conditions remain supportive of economic growth. Although the pace of economic recovery is likely to be moderate for a time, the Committee anticipates a gradual return to higher levels of resource utilization in a context of price stability.
>
> With substantial resource slack continuing to restrain cost pressures and longer-term inflation expectations stable, inflation is likely to be subdued for some time.
>
> The Committee will maintain the target range for the federal funds rate at 0 to 1/4 percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period.

Although the Fed tries to influence long-term capital costs through its adjustments to the Fed Funds rate, long-term capital costs do not always respond. Therefore, it is important to analyze and consider the long-term interest rate environment when recommending a reasonable cost of common equity.

Long-term interest rates, as measured by Thirty-year Treasury bonds (30-year T-bonds), dropped to historically low levels at the end of 2008 and early 2009. However, they have since started to return to levels more consistent with recent years. As of March 2010, the yield on 30-year T-bonds averaged 4.64 percent (see Schedule 4-2), which is an increase from an all-time low in December 2008 of 2.87 percent. However, because of investors' concerns about the economy during the last quarter of 2008, the average utility bond yield increased to as high as 7.80 percent, as of November 2008, and has since stabilized to more historical levels, averaging

5.94 percent in February 2010. The spread between the utility bond yields and 30-year T-bond yields hit an historical high of 400 basis points in December 2008 (see Schedule 4-4). The spread between the utility bond yields and 30-year T-bond yields decreased to 121 basis points in March 2010. In spite of an increase in utility bond yields from 5.60 percent in September 2010 to 5.90 percent in March 2010, the increase still represents an aggregate decrease of 190 basis points since its recent peak in November 2008.

D. Overview of Atmos Energy Corporation's Operations, Financing and Staff's Proposed Approach for Estimating Atmos' Jurisdictional Cost of Capital

The following excerpt from Atmos Energy Corporation Form 10-K filing with the SEC for the 2009 calendar year provides a good description of Atmos Energy Corporation's current business operations:

<u>Overview:</u>

<u>Atmos Energy Corporation</u>:

> Atmos Energy Corporation, headquartered in Dallas, Texas, is engaged primarily in the regulated natural gas distribution and transmission and storage businesses as well as other non-regulated natural gas businesses. Since our incorporation in Texas in 1983, we have grown primarily through a series of acquisitions, the most recent of which was the acquisition in October 2004 of the natural gas distribution and pipeline operations of TXU Gas Company. We are also incorporated in the state of Virginia.

<u>Areas of operation</u>:

> Today, we distribute natural gas through regulated sales and transportation arrangements to over 3 million residential, commercial, public authority and industrial customers in 12 states located primarily in the South, which makes us one of the country's largest natural-gas-only distributors based on number of customers.

> We also operate one of the largest intrastate pipelines in Texas based on miles of pipe. Through our non-regulated businesses, we

primarily provide natural gas management and marketing services to municipalities, other local gas distribution companies and industrial customers primarily in the Midwest and Southeast and natural gas transportation along with storage services to certain of our natural gas distribution divisions and third parties.

<u>Growth</u>:

We have experienced more than 25 consecutive years of increasing dividends and earnings growth after giving effect to our acquisitions. Historically, we achieved this record of growth through acquisitions while efficiently managing our operating and maintenance expenses and leveraging our technology to achieve more efficient operations. In recent years, we have also achieved growth by implementing rate designs that reduce or eliminate regulatory lag and separate the recovery of our approved margins from customer usage patterns. In addition, we have developed various commercial opportunities within our regulated transmission and storage operations. Finally, we have strengthened our non-regulated businesses by increasing sales volumes and improving per-unit margins.

<u>Natural Gas Distribution Segment Overview</u>

Revenues in this operating segment are established by regulatory authorities in the states in which we operate. These rates are intended to be sufficient to cover the costs of conducting business and to provide a reasonable return on invested capital. Our primary service areas are located in Colorado, Kansas, Kentucky, Louisiana, Mississippi, Tennessee and Texas. We have more limited service areas in Georgia, Illinois, Iowa, Missouri and Virginia. In addition, we transport natural gas for others through our distribution system.

Rates established by regulatory authorities often include cost adjustment mechanisms for costs that (i) are subject to significant price fluctuations compared to our other costs, (ii) represent a large component of our cost of service and (iii) are generally outside our control.

Finally, regulatory authorities have approved weather normalization adjustments (WNA) for over 90 percent of residential and commercial meters in our service areas as a part of our rates. WNA minimizes the effect of weather that is above or below normal by allowing us to increase customers' bills to offset lower gas usage when weather is warmer than normal and decrease

> customers' bills to offset higher gas usage when weather is colder than normal.

Atmos Energy Corporation has a current S&P corporate credit rating of "BBB+". The following is an excerpt from a March 31, 2010 S&P credit-rating report:

> The rating on Dallas, Texas-based Atmos Energy Corp. reflects an 'excellent' business risk profile and 'significant' financial risk profile. The rating is based on the consolidated business and financial risk of the company, including the non-regulated operations. Standard & Poor's rating on Atmos balances the strong cash flow generated by the regulated gas distribution and pipeline operations (about 75% to 80% of consolidated operating income) with the more speculative cash flows that natural gas marketing operations contribute.
>
> Atmos' 'significant' financial risk profile has strong regulated cash flows, relatively high leverage, and the increased risks associated with its non-regulated marketing operations, which have less cash flow predictability and greater competitive risks. Notwithstanding the volatility associated with Atmos Energy Holdings' (AEH) financial performance, bondholder protection measures have improved since the fiscal 2005 acquisition of TXU Gas and are currently adequate for the rating.

Atmos Energy Corporation has a common equity ratio of 50.97 percent as of February 28, 2010, but S&P still views Atmos Energy Corporation as having a "significant" financial risk profile. Additionally, although S&P continues to assign Atmos Energy Corporation an "excellent" business risk profile, the increased risks associated with non-regulated marketing operations appear to be of concern to S&P.

Staff recognized that Atmos Energy Corporation had an 'A' credit rating prior to its historical and major acquisition of Dallas' TXU Gas Company in 2004. After the acquisition, Atmos Energy Corporation was downgraded to a 'BBB-' credit rating. A March 31, 2010 S&P credit report reveals that Atmos' Funds from Operations (FFO) to total debt and interest ratios show a gradually improving trend. The report also disclosed that leverage is expected to continue to decline as total capitalization from retained earnings continues to grow. Atmos' Energy Corporation's credit rating is currently perched at 'BBB+'.

Atmos' acquisition growth strategy, which is obviously outside the business scope of operating a Missouri local gas distribution company, and risks caused by Atmos' non-regulated operations are still affecting the consolidated credit profile. Therefore, Staff did not make an adjustment to its recommended ROE.

<u>Historical Capital Structures and Ratios</u>

Schedules 6 and 7 present Atmos' historical capital structures and selected financial ratios from 2005 to 2009. Atmos Energy Corporation's consolidated common equity has increased considerably, from 40.74 percent in 2005 to 49.26 percent in 2009 (see Schedule 5). Atmos Energy Corporation's consolidated earned ROE for the last five years has ranged from a low of 8.30 percent to a high of 9.80 percent from 2005 through 2009. Atmos Energy Corporation's consolidated 2009 earned ROE was 8.30 percent. In a March 12, 2010, report in *The Value Line Investment Survey: Ratings & Reports*, Value Line estimates that Atmos Energy Corporation's consolidated 2010 ROE will be 9.00 percent.

<u>Capital Structure and Embedded Costs</u>

As explained earlier in this Report, Staff used Atmos Energy Corporation's consolidated capital structure as at February 28, 2010 (see Schedule 7). As the schedule indicates, Staff apportioned the total capital (in dollar amounts) into specific capital components, i.e. common equity, long-term debt, and short-term debt; followed by a calculation of the percentage weight of each component relative to total capital. The resulting capital structure consists of 50.87 percent common stock equity, 47.50 percent long-term debt and 1.53 percent short-term debt.

The amount of long-term debt outstanding for Atmos Energy Corporation as of February 28, 2010 was $2,159,855,937 and embedded cost of long-term debt was 6.82 percent (see Schedule 8). Embedded cost of debt is computed by dividing the net proceeds balance (i.e. principal long-term debt balance net unamortized discount and issuance expense balance) by total annual debt cost balance (i.e. annual debt costs plus total annual amortization balance). Embedded short-term debt cost of 0.26 percent was provided by Company Staff in response to Staff's Data Request No. 122.

E. Determination of Cost of Capital

The discounted cash flow (DCF) model is widely recognized as an appropriate model to utilize in arriving at a reasonable recommended return on equity that should be authorized for a utility. Therefore, Staff determined its recommended cost of common equity by applying the DCF model to a comparable group (proxy group) of natural gas distribution companies. Staff selected the DCF model (explained in detail in Attachment A) as the primary tool to determine the cost of common equity for Atmos. Staff also selected the CAPM (explained in detail in Attachment B) to check the reasonableness of the DCF results.

Proxy Group Selection

Staff started with a group of companies classified as natural gas distribution companies by Edward Jones in their March 31, 2010 *Edward Jones Natural Gas Industry Summary* publication. Schedule 9 presents a list of the 11 companies that Edward Jones currently follows and classifies as natural gas distribution companies. Staff then applied the following criteria to these 11 companies in order to select its ultimate proxy group: 1) Stock publicly traded, 2) Information printed in Value Line, 3) Ten years of data available, 4) At least investment grade credit rating, 5) Two sources for projected growth available with one of those being from

Value Line and 6) No reduced dividend since 2007. This resulted in a group of seven publicly-traded gas utility companies, including Atmos (see Schedule 10). Staff believes that these Companies are reasonable proxy's for use in estimating the cost of common equity of Atmos.

DCF Methodology explained

The DCF cost of equity equation may also be algebraically represented as:

$$\mathbf{k = \frac{D_1}{P_0} + g}$$

Where: K = Cost of Capital;

D_1 = Next 12 months dividend;

P_0 = Current stock price; and

g = Dividend growth

DCF Step One

In performing its constant-growth DCF analysis Staff first estimated a growth rate (g). Staff reviewed the actual dividends per share (DPS), earnings per share (EPS), and book values per share (BVPS), as well as projected DPS, EPS and BVPS growth rates for the comparables. Schedule 11-1 lists the annual compound growth rates of each comparable company for DPS, EPS, and BVPS for the past ten years. Schedule 11-2 lists the annual compound growth rates for DPS, EPS, and BVPS for the past five years. Schedule 11-3 presents the averages of the growth rates shown in Schedules 11-1 and 11-2.

Staff also analyzed the projected DPS, EPS and BVPS as estimated by Value Line for each comparable company over the next five years. (see Schedule 12) The average of these projected growth rates was lower than the average of the five and ten-year historical averages.

Staff used the following growth rates to formulate its range: Value Line historical – 5.88 percent, Value Line projected five-year annual compound – 4.36 percent, equity analysts' five-year projected earnings growth obtained from Reuters website and Value Line 3-5 year earnings growth – 4.64 percent. Based upon this information and in Staff's professional judgment, Staff determined a growth (g) range of 4.75-5.75 percent to be appropriate and used this range in Staff's DCF model in this case.

<u>DCF Step Two</u>

The next step in Staff's DCF analysis was to calculate an expected dividend yield for each of the comparables. The dividend yield term of the constant-growth DCF was calculated by dividing the amount of DPS expected to be paid over the next 12 months (D_1) by the market price per share of the firm's stock (P_0) (See equation above). Staff decided to use a weighted average of the 2010 and 2011 projected DPS from Value Line to approximate investors' expected dividends over the next 12 months. Staff applied 50 percent weight to the projected 2010 DPS and 50 percent weight to the 2011 projected DPS. Staff believes that this is a reasonable proxy for dividend expectations because if investors purchase any one of these stocks, this would be the amount of dividends they could reasonably expect to receive over the next 12 months (see Schedule 15).

It is important to ensure the selection of stock prices that reflect investors' current expectations of the business and economic climate. Staff believes the use of stock prices for the three months through the end of April 2010 is reasonable as this reflects investors' analysis of the current economic conditions and the impact it is having on their expectations of future returns and the risk of these returns. It should be noted that Staff's use of three months of average stock prices for the comparable group is different from its past practice of using four months of stock prices. Staff decided to make this change because most financial data is reported at least on a quarterly basis. The monthly high/low averaging technique minimizes the effects on the dividend yield which can occur due to short-term volatility in the stock market. The technique averages the highest and lowest stock price of each month in the selected period to derive P_0 (current stock price) (See equation above). Schedule 14 presents the average high/low stock price for the period of February 1, 2010, through April 30, 2010, for each comparable.

Column 1 of Schedule 16 indicates the expected dividend for each comparable over the next 12 months as derived from the most recent Value Line report. Column 3 of Schedule 15 shows the projected dividend yield for each of the comparables. The dividend yield for each comparable was averaged to estimate the projected-average-dividend yield for the comparables of 4.20 percent. Considering the Commission's position regarding the quarterly-compounding of dividends expressed in its Report and Order in a recent Union Electric rate case, Case No. ER-2008-0318, it is important to note that this dividend yield has not been adjusted for quarterly compounding. Staff is attempting to estimate investors' expectations and, because the Value Line quoted dividend yield does not reflect quarterly compounding, Staff is not convinced that investors' analyze the expected dividend yield on a quarterly-compounded basis.

As shown on Schedule 15, Staff's estimate of the proxy group's cost of common equity based on the projected dividend yield and a growth rate range of 4.75 to 5.75 percent is 8.95 percent to 9.95 percent.

CAPM Test of Reasonableness

To verify the reasonableness of the Staff's DCF cost of common equity, the Staff performed a CAPM cost of common equity analysis on the comparables. The CAPM requires estimates of three main inputs, the risk-free rate, the beta and the market risk premium. For purposes of this analysis, the risk-free rate Staff used was the yield on thirty-year U.S. Treasury bonds. The Staff determined the appropriate rate to be the average yield for April 2010 of 4.69 percent, which was obtained from the St. Louis Federal Reserve Bank website.

For the second variable, beta, the Staff used Value Line's betas for the comparable group of companies. Schedule 16 contains the appropriate betas for the comparables.

The final term of the CAPM is the market risk premium (R_m - R_f). The market risk premium represents the expected return from holding the entire market portfolio, less the expected return from holding a risk-free investment. The Staff relied on risk premium estimates based on historical differences between earned returns on stocks and earned returns on bonds.

The first risk premium the Staff used was based on the long-term, arithmetic average of historical return differences from 1926 to 2009, which was 6.00 percent. The second risk premium used was based on the long-term, geometric average of historical return differences from 1926 to 2009, which was 4.40 percent. These risk premiums were taken from Ibbotson Associates, Inc.'s *Stocks, Bonds, Bills, and Inflation: 2010 Yearbook.*

Schedule 18 presents the CAPM analysis of the comparables using historical actual return spreads to estimate the required equity risk premium. The CAPM analysis using the long-term arithmetic average risk premium and the long-term geometric average risk premium produces estimated costs of common equity of 8.59 percent and 7.55 percent respectively.

Weighted Average Cost of Capital

In reference to Schedule 19, Staff subsequently calculated Atmos' overall weighted average cost of capital (WACC) by summing up the WACC for each capital component. The component costs were computed by (1) multiplying common stock equity by the estimated cost of common equity/ common equity return calculated in Schedule 15, (2) multiplying short-term debt capital component by average short-term debt cost provided in Staff Data Request No. 122; and (3) multiplying the long-term debt capital component ratio by the embedded cost of debt (see Schedule 8). This total weighted average cost of capital (WACC) is synonymous with the fair rate of return for the utility company.

A company's authorized WACC is considered a just and reasonable rate of return (ROR) under normal circumstances. From a financial viewpoint, a company employs different forms of capital to support, or fund, the assets of the company. Each different form of capital has a cost, and these costs are weighted proportionately to fund each dollar invested in the assets. Assuming that the various forms of capital are within a reasonable balance and are valued correctly, the resulting total WACC, when applied to rate base, will provide the funds necessary to service the various forms of capital. Thus, the total WACC corresponds to a fair rate of return for the utility company.

Regulatory Research Associates Data

Although Staff recommends that the Commission rely primarily on the Staff's cost-of-common-equity recommendation using its constant-growth DCF analysis in this case when authorizing a fair rate of return, Staff recognizes that the Commission has expressed a preference in past cases to at least consider the average authorized returns as published by the Regulatory Research Associates (RRA). According to RRA, the average authorized ROE for gas utility companies for the first quarter of 2010 was 10.24 percent, based on nine decisions.

The average authorized ROE for gas utility companies for 2009 was 10.19 percent based on 29 decisions (first quarter – 10.24 percent based on four decisions; second quarter –

10.11 percent based on eight decisions; third quarter – 9.88 percent based on two decisions; fourth quarter – 10.27 percent based on fifteen decisions).

Although average authorized ROEs tend to garner the most attention in rate cases, it is also important to consider average authorized rates of return (RORs) to provide some context for average authorized ROEs. Some companies' costs of debt may cause their ultimate authorized return to be somewhat higher than the average. Although the cost of debt is only adjusted in extraordinary circumstances (for instance, in past Aquila rate cases, the cost of debt was adjusted to make it consistent with investment grade costs), there may be concerns about the reasonableness of these costs. Because it is the overall ROR (not the quoted average authorized ROE) that is applied to rate base to determine the revenue requirement, it would appear that this average would also be important in testing the reasonableness of the total cost of capital.

The average authorized ROR for gas utilities for the first quarter of 2010 was 8.20 percent based on ten decisions. The average authorized ROR for gas utilities in 2009 was 8.15 percent based on 28 decisions (first quarter – 8.11 percent based on five decisions; second quarter – 8.05 percent based on seven decisions; third quarter – 8.30 percent based on two decisions; fourth quarter – 8.19 percent based on fourteen decisions).

It is, however, important to note that Staff has not researched the specifics of the cases cited in the RRA reports cited herein.

F. Conclusion

Under the cost of service ratemaking approach, a Staff estimated Atmos' WACC to fall in the range of 7.81 percent to 8.32 percent (see Schedule 19). This rate was calculated by applying an embedded cost of long-term debt of 6.82 percent and a cost of common equity range of 8.95 percent to 9.95 percent to a capital structure consisting of 50.97 percent common equity, 47.50 percent long-term debt and 1.53 percent short-term debt.

From a financial risk/return prospective Staff recommends that Atmos Energy Corporation be allowed to earn a return on its rate base in the range of 7.81 percent to 8.32 percent. Staff believes that it has developed a fair and reasonable return estimate, which, when applied to Atmos' rate base, will allow Atmos the opportunity to earn a fair and reasonable return.

Staff Expert/Witness: Zephania Marevangepo

VI. DEVELOPMENT OF ACCOUNTING SCHEDULES AND ADJUSTMENTS

A. Cost of Service and Revenue Deficiency - Accounting Schedule 1

Staff's recommended overall base rate increase for each of the three Missouri Rate Divisions is summarized on Accounting Schedule 1. The supporting schedules for the various elements underlying components reflected on the noted Cost of Service and Revenue Deficiency Summary are referenced within Accounting Schedule 1.

Staff Expert/Witness: James R. Dittmer

B. Rate Base - Accounting Schedule 2

Accounting Schedule 2 reflects the three Missouri Rate Divisions' rate base by major component. Plant in Service, Accumulated Depreciation Reserve and Accumulated Deferred Income Taxes are reflected as of February 28, 2010. A number of working capital components have been developed based upon an average of monthly balances for the 13 months ending February 2010. The Cash Working Capital (CWC) Allowance was developed by utilizing a lead lag study. The development of each major rate base component is discussed in greater detail in immediately following sections of this report.

Staff Expert/Witness: James R. Dittmer

C. Net Plant – Accounting Schedule 3

Accounting Schedule 3 reflects Atmos' actual Net Plant in service balance directly assigned or allocated to each Missouri Rate Division as of February 28, 2010. The directly-assigned plant consists of distribution property located within each noted Rate Division. Centralized Shared Services plant facilities, other than Call Center facilities, have been allocated to the Regional Operating Division by employment of a four-factor General Allocator (See separate Section VII.B.2. of this Report entitled "Four-factor Allocator for Certain Shared Services Cost Centers"). Plant investment at the regional Operating Divisions, as well as Dallas centralized facilities investment allocated to each regional Operating Division via the four-factor allocator, is allocated to each Missouri Rate Division via the three-factor general allocator.

Centralized Call Center plant investment costs are allocated initially to regional Operating Divisions, and ultimately to each Missouri Rate Division, via employment of an allocation factor that was developed based upon average number of customers.

Staff Expert/Witness: James R. Dittmer

D. Cash Working Capital – Accounting Schedule 4

Cash working capital represents the amount of cash required to be paid for day-to-day expenses incurred in providing service to ratepayers. In some instances, payments for goods and services are paid shortly after, or even before, the goods are received/utilized or the services are performed. In other instances, the payment for a good or service received occurs long after the good or service is received. If, on average, the payment for goods or services utilized in the provision of utility service is made *before* receipt of related customer revenues, the utility will have a relatively constant and permanent investment in cash working capital (i.e., a constant investment in the prepayment of cash expenses made in advance of the receipt of related service revenue.) Conversely, if on average, the payment for goods or services utilized in the provision of utility service is made *after* receipt of related customer revenues, the utility will enjoy a relatively constant and permanent source of cost free funds supplied by ratepayers (i.e., ratepayers provide cost free capital to the utility in the form of payment for utility service prior to the time that the utility is required to pay "cash" for goods and services consumed in providing the utility service).

Atmos undertook a detailed lead lag study designed to calculate the ongoing amount of cash working capital required to be invested to provide utility service to Missouri retail ratepayers. The Staff has traditionally employed, and this Commission has traditionally adopted, lead lag studies to develop the allowable amount of cash working capital to include in the development of regulated utility companies' rate bases. Staff has reviewed the Company's detailed lead lag study. The documentation for revenue and expense component lags was reviewed – either individually or through sampling. Additionally, lags calculated in this case were compared to lags calculated in Atmos' previous Missouri ratemaking as an additional effort to identify possible errors or problems within the Company's current lead lag study. Staff has determined that, in general, Atmos' lead lag study was comprehensive, reasonably accurate, and in compliance with this Commission's standards for rate base inclusion. In particular, the Staff notes that Atmos included only "cash" expenses within its detailed lead lag study. As discussed in the following paragraphs, Staff has taken exception to two specific areas of the Company's CWC calculation. However, this does not mean the Staff is in complete agreement with all aspects of the rest of the Company's analysis. Rather, the Staff's review and proposed adjustments to the Company's analysis reflect its assessment of the most appropriate use of its time and resources in this rate case.

Based on its review of Atmos' lead lag study, Staff takes exception to the revenue collection lag that Atmos has calculated as a component of its overall calculated revenue lag. Additionally, Staff takes exception to the Company's calculation of the average expense payment lag that Atmos developed for the category of "Other Operations and Maintenance (O&M) Expenses."

1. Revenue Lag

The "revenue lag" measures the time from the provision of utility service until receipt of related service revenues. The revenue lag is typically measured in three components consisting of 1) the lag from the mid-point of providing service (i.e., the service period lag), 2) the billing lag (i.e., the period from the end of the service period until a bill is issued), and 3) the collection lag (i.e., the period from the time a bill is tendered until receipt of customer revenues). Based on its review, Staff is recommending a revised calculation for the revenue collection lag.

In determining the "collection lag," Atmos divided the "average daily accounts receivable" balance by the "average daily revenues billed" for the twelve month period ending June 30, 2009 to arrive at an "average number of days billed revenues" that resided within the daily average receivables balance. The Company's calculation resulted in a "revenue collection lag" of slightly over 23 days. Notably, Atmos is authorized pursuant to Missouri tariffs to collect and retain a delinquent fee of one and one half percent (1.5%) of the total amount due from Residential customers after 21 days, and after 14 days for all other classes of customers. The implication of the Company's calculated revenue collection period lag is that, on average, Missouri ratepayers are paying their bills after the period of time when a delinquency fee would be charged. Importantly, delinquency fees were much less than one and one-half percent of test year revenues. While such observation in and of itself is not conclusive that a problem exists with the Company's revenue collection lag, it certainly raises a serious question.[6]

Through discovery Staff has ascertained two problems with the Company's collection lag calculation. First, in some instances, payments received from customers are not posted as a reduction to the daily accounts receivable balance exactly on the day received. The inability to deduct customer receipts from the daily accounts receivable balance upon actual day of receipt in all customer payment instances, has the effect of slightly over stating the true or actual daily accounts receivable balance used in the Company's calculation of the revenue collection lag.

More importantly, Staff has determined that there is a mismatch in the data used in the "average daily accounts receivable" balance and the data used within the "average daily revenues billed" considered within the Company's revenue collection lag calculation. Specifically, Atmos is required to assess sales and franchise taxes in certain rate divisions. Such sales and franchise taxes are "adders" to the customers' bills and are *not* considered in the development of base rates. However, the revenues received, and payments made to taxing authorities, for such sales/franchise taxes are not recorded as "revenues" with offsetting "expenses" on the Company's income statement. In a sense, the Company is merely a collector of a tax for the various taxing authorities, with only a responsibility to "pay" the taxes received to the taxing authorities.

[6] The Company has a level payment plan that also affects the accounts receivable balance that could cause the calculated "collection lag" to be longer than the delinquency period allowed without the observance of a significant level of "forfeited discount" (late fee) revenues. This result can occur when customer collections under the level payment plan fall behind what amounts would have been "billed" absent the level payment plan for many months of a given twelve month period.

While the billing and payment of sales/franchise taxes do not affect Atmos' income statement (i.e., recorded revenues or recorded expenses), Atmos' balance sheet accounts are nonetheless impacted by such transactions. Specifically, the sales/franchise taxes are included in the Company's accounts receivable balance, with a directly offsetting liability account to reflect amounts expected to be paid to the taxing authorities. Thus, the Company's calculation of the "average daily accounts receivable" balance used in the Company's revenue collection lag contains not only amounts billed for utility service provided, but additionally, reflects the balance of sales/franchise taxes billed on behalf of the various taxing authorities. However, these taxes are not reflected in the "billed revenues" used by the Company in the collection lag calculation. Because the Company divided "average daily accounts receivable" balances which included sales/franchise taxes by "average daily revenues billed" balances that did *not* include such sales/franchise taxes billed on behalf of taxing authorities, the Company's calculated collection lag has been overstated. More specifically, the "average daily accounts receivable" balances have been overstated by the amount of sales/franchise taxes included in such balances. This overstatement of "average daily accounts receivable" balances that are not synchronized with "average daily revenues billed" results in an overstatement of the number of days of "revenues billed" that resides within the accounts receivable balance. Or in short and in sum, the Company's collection lag has been overstated due to a mismatch of data used in the calculation.

The problem of the mismatch in revenues and accounts receivable balances was not identified until late in the audit. Staff has discovery outstanding designed to permit a more precise calculation of Atmos' actual collection lag. For purposes of preparing its recommendation included in this report, Staff has assumed a collection lag of 20 days. Such lag is one day less than the 21 days allowed Residential customers to pay their bills before incurring a late payment fee, and six days beyond the period that non-residential customers are required to pay their bills to avoid a late payment fee. Further, such collection lag is approximately the same collection lag used by Staff in Atmos' prior Missouri rate case (i.e., in the last case Staff reflected a collection lag of 20.16 days). If better data is obtained, and a more refined calculation can be undertaken, Staff will change its recommendation on a collection lag as appropriate. However, given what is known to be incorrect with the Company's calculation, use of an assumed 20-day collection lag appears reasonable if not conservatively long.

2. "Other O&M Expense" Service Lag

An expense service lag represents the average period between when a good or service is received and when the utility is required to pay a vendor or an employee for such good or service. For example, Atmos receives service from employees during a two week period prior to paying wages to these employees. This service period is divided by two to determine the average service date. The average service date is compared to the date the utility pays for this service to calculate an expense lag. The payment process for every expense item is not individually examined in a lead-lag analysis. Categorized groups of expenses are often sampled to arrive at a category-specific expense lag. In Atmos' lead-lag analysis expenses not analyzed in a specific category were residually grouped into an "Other O&M Expenses" category wherein a separate sampling of cash vouchers was undertaken. Atmos included 3,400 items within its sample of cash vouchers to develop its calculation of the "Other O&M Expenses" expense lag. With an automated process the Company was able to download in many instances a "service period" as well as the actual "payment" date from invoice data maintained on its accounts payable system. However, in the majority of instances, the data maintained within its accounts payable system simply did not provide an actual "service period." In those instances where no "service period" was identified, the Company assumed the "service period," or the mid-point of the "service period," was the invoice date. The result of assuming that the invoice date was the "service period" significantly shortened the calculated "payment lag."

The Company can undoubtedly point to transactions wherein assuming the invoice date is the mid-point of the service period actually *overstates* the payment lag. However, there are numerous instances wherein this assumption significantly understates the payment lag. For instance, payment of employee credit cards used to pay for travel and other reimbursable items would occur days after the actual good or service was purchased for use in the provision of utility service. More specifically, credit card statements are typically issued monthly, with the cut off for items being billed occurring a day or two before the "statement" or "invoice" date. By assuming the "invoice date" for credit card bills is the mid-point of the service period, Atmos has understated the payment lag by over 15 days (i.e., the mid-point of the typical 30-day service period for credit card bills would be at least 15 days prior to the "invoice date" shown on the statement).

Staff has calculated a payment lag for "Other O&M Expenses" by simply eliminating all items included within the Company's sample of "Other O&M Expense" payments which had been calculated by assuming the mid-point of the service period was the "invoice date". Elimination of such transactions resulted in a sample of 1,071 remaining transactions (out of the Company's total original sample of 3,441 transactions). With in excess of one thousand transactions included within the calculation, Staff believes the remaining sample of transactions is quite adequate to develop a reliable estimate of the expense payment lag for this category of "Other O&M Expenses." As a result of the Staff's elimination of the transactions where the

Company was unable to measure the actual service lag, the "Other O&M Expense" lag is 32.38 days as opposed to the 15.37 days originally calculated by Atmos.

Staff Expert/Witness: James R. Dittmer

E. Storage Gas Inventory, Prepayments and Fuel Stock Inventory - Accounting Schedule 2 Lines 11, 16 and 17

Atmos maintains a small amount of propane fuel stock in Hannibal, Missouri (serving Northeastern District Division customers) for peaking purposes. Additionally, Atmos maintains an inventory of purchased gas that it holds within interstate pipeline storage facilities. A 13-month average of propane fuel stock and storage gas was developed and has been included in rate base development on Accounting Schedule 2. Such inventories represent an ongoing investment for Atmos that are properly considered within rate base development.

Atmos prepays for insurance coverage under a number of different policies. Additionally, certain information technology maintenance contracts are prepaid. Accordingly, Accounting Schedule 2 also includes in rate base development a 13-month average of Atmos prepayments. A number of prepayments are incurred centrally on a Shared Services corporate-wide basis. A few prepayments are also incurred at the regional Operating Division level. Centrally acquired Shared Services prepayments as well as regionally acquired Operating Division prepayments are allocated to the Missouri Rate Divisions pursuant to cost allocation methodologies discussed within Section VII of this report entitled "Allocation of Corporate Costs."

Staff Expert/Witness: James R. Dittmer

F. Miscellaneous Rate Base Offsets - Accounting Schedule 2 Line 9

When developing its purported revenue deficiency the Company failed to recognize certain reserves on its balance sheet established to reflect expenses accrued, and paid for via receipt of utility customer revenues, in advance of the Company's actual related payments for such expenses. Specifically, Staff has identified three transactions wherein Atmos accrues expenses in advance of actual payments. Those three transactions, which result in the calculation of rate base reductions reflected on line 9 of Accounting Schedule 2, consist of the following:

- Non-Qualified Deferred Director's Compensation
- Miscellaneous Accruals
- Self Insurance Reserves

Staff notes that for each of the reserves listed, Atmos is permitted to only deduct amounts actually "paid" within a given tax year for purposes of calculating taxable income. Therefore, expense amounts accrued for financial statement reporting and ratemaking purposes above "paid" amounts within any given reporting period represent book/tax timing differences for which Accumulated Deferred Income Tax (ADIT) balances are reserved – with each ADIT balance representing a prepayment of taxes in advance of the receipt of related customer service revenues. Staff emphasizes that for each ADIT balance associated with each of the reserves and liabilities listed above that Atmos has included such "prepayment" ADIT as a rate base addition. The implication, whether intended or not, is that ratepayers should pay a return on the "prepayment" ADIT investment amounts related to the noted reserves, but that the related cost free reserves themselves are not appropriately deducted in the development of rate base. Each of the reserves listed represents a source of cost free capital provided by ratepayers that is appropriately deducted when developing rate base in this proceeding. It would be a particularly inequitable outcome if the related ADIT balances associated with the noted reserves were included in rate base development while the actual cost free reserves themselves were ignored when developing rate base.

Staff Expert/Witness: James R. Dittmer

G. Prepaid Pension Asset - Accounting Schedule 2 Line 13

The balance of the Prepaid Pension Asset as of February 28, 2010 is also included in rate base development shown on Accounting Schedule 2. The Prepaid Pension Asset reflects the amount actually contributed to the pension fund in excess of the amount of pension cost provided in rates as "pension expense". The Prepaid Pension Asset account is maintained on an Atmos company-wide basis. The Missouri Rate Divisional allocated balances are developed pursuant to cost allocation methodologies discussed within Section VII.A. of this report entitled "Allocations."

Staff Expert/Witness: James R. Dittmer

H. Associated Natural Gas Company Acquisition Order Rate Base Credit – Accounting Schedule 2 Line 23

This Commission approved Atmos' purchase of Missouri gas distribution property formerly owned by Associated Natural Gas Company in Case No. GM-2000-272. Within that case Atmos agreed to use as an additional rate base offset, for a period of ten years following the closing date of the acquisition, an amount that was designed to compensate ratepayers for deductions from rate base that were being eliminated by the purchase transaction. The original rate base deduction amount of $2.5 million was to be amortized over a 120 month period beginning in June 2000. Shown on Accounting Schedule 2 is the unamortized rate base credit as of February 28, 2010 that Atmos agreed within Case No. GM-2000-272 to reflect as a rate base reduction.

Staff Expert/Witness: James R. Dittmer

I. Customer Advances and Customer Deposits - Accounting Schedule 2 Lines 5 and 7

Atmos' Missouri ratepayers provide *cost free* funds to the Company in the form of Customer Advances for Construction. Atmos' Missouri ratepayers provide *low cost* funds to the Company in the form of Customer Deposits. Accounting Schedule 2 reflects as rate base reductions February 28, 2010, ending 13-month averages of Customer Advances for Construction and Customer Deposits.

The current annual interest rate authorized by this Commission to be paid on Customer Deposits is 4.25%. The annualized interest cost applicable to the 13-month average of Customer Deposits has been included as an above-the-line operating expense on Accounting Schedule 6. Including the interest on Missouri Customer Deposits as an above-the-line operating expense for rate setting purposes is the methodology routinely employed when establishing Missouri retail rates and the methodology that Atmos also reflected when developing its proposed Missouri retail jurisdictional adjusted test year cost of service.

Staff Expert/Witness: James R. Dittmer

J. Deferred Income Tax Balance - Accounting Schedule 2 Line 3

Atmos' Missouri operations are afforded "normalization" accounting and ratemaking treatment for the various book/tax timing differences that result when an item of income or expense is recognized for financial statement reporting and ratemaking purposes at a different time than the income or expense is recognized when calculating current taxable income on federal and state income tax returns. Under "normalization" tax accounting, even though "current" income taxes are calculated based upon taxable income determined when filing the utility's federal and state corporate tax returns, for cost of service ratemaking purposes, income tax expense is calculated by generally only considering income as reported for public financial statements.

In the majority of instances expenditures can be deducted sooner, or on an accelerated basis, for purposes of calculating taxable income than expenditures are recognized as "expenses" for financial statement reporting purposes. When expenditures are deducted sooner for purposes of calculating federal and state taxable income than they are recognized as "expenses" for financial statement reporting purposes, a related ADIT balance is created to quantify the difference between income taxes actually being paid (i.e., current income tax expense) and the amount of income tax expense being collected in rates (i.e., calculated on income as reported per public financial statements which consists of current *plus* deferred income tax expense). The *net* amount of taxes collected in rates in excess of federal and state income taxes paid, residing in ADIT subaccounts, are properly deducted in rate base development inasmuch as such balances represent cost free capital to the utility.[7] As stated, in the majority of instances an expenditure can be recognized sooner or on an accelerated basis as a deduction for purposes of calculating taxable income than it is reflected as an "expense" for financial statement reporting purposes. That said, there are nonetheless a number of transactions wherein items are "expensed" for financial statement reporting sooner than they are taken as a "deduction" for purposes of calculating taxable income. In those instances, the related ADIT balance represents the payment of a tax liability by the utility *in advance* of the receipt of tax expense being recovered within

[7] There are a limited number of book/tax differences that are "permanent" in nature. Accumulated Deferred Income Taxes are established only for book/tax "timing" differences.

customers' rates. In those instances the ADIT balance effectively represents a "prepaid income tax expense" investment made by the Company upon which it is entitled an opportunity to earn a rate base rate of return.

Staff reviewed all ADIT balances at February 28, 2010 (the cutoff for the true-up in this case) for each Atmos division that provides services to Missouri ratepayers to determine which balances were proper for rate base consideration. A number of ADIT balances that Staff proposes to remove from the total population of ADIT balances existing at February 28, 2010 were properly eliminated by Atmos when developing the Company's proposed Missouri jurisdictional rate base. Those ADIT balances not included in rate base development by either Company or Staff include:

- Deferred Expense Projects
- Deferred Gas Costs
- Over Recoveries of Purchased Gas Costs

From Staff's perspective, the noted ADIT items are either non-jurisdictional or considered to be a volatile quick turnaround item that can swing from positive to negative values in a short period of time that cannot be viewed as a relatively stable source of cost-free capital or a longer term investment in "prepaid income tax expense" (i.e., as in the case of Deferred Gas Costs and Over Recoveries of Purchased Gas Costs).

Staff also excluded seven ADIT components from rate base development that Atmos did not remove when developing its proposed Missouri jurisdictional rate base. Those seven additional ADIT components that Staff is proposing to *exclude* from rate base development consist of:

- Management Incentive Plan/Variable Pay Plan
- Restricted Stock Grant Plan related to the Company's Long Term Incentive Plan
- Restricted Stock – Management Incentive Plan
- Stock Option Expense related to the Company's Long Term Incentive Plan
- Supplemental Executives Benefits Plan
- Post Retirement Medical Benefits (FAS 106 expenses)
- Tax Free Interest – IRS dispute

The first four of the noted ADIT components are related to Atmos' various incentive compensation plans. Each of the noted ADIT balances, if considered in rate base development, would *increase* the Missouri jurisdictional rate base total. This occurs as a result of the fact that incentive compensation is generally "expensed" on the Company's financial statements in advance of the time that the compensation is actually paid to employees and deducted for tax purposes. Or in other words, these incentive compensation-related ADIT balances each constitute a transaction wherein the utility must pay taxes to federal and state authorities prior to receipt of related expense recovery within utility rates.

As noted within an ensuing separate section of this Staff Report, Staff is recommending disallowance of all of the costs of Atmos' incentive compensation plans. Consistent with that recommendation, Staff is proposing to eliminate all rate base effects of the Company's incentive compensation plans – including the noted ADIT balances.

Staff notes that while Atmos did include incentive compensation-related ADIT balances in rate base development (with the effect resulting in an *increase* to rate base), it failed to reflect as a rate base *deductions* related balance sheet reserve accounts that capture the amount of incentive compensation "expensed" on the Company's financials that has not yet been paid to employees. Specifically, the incentive compensation reserves represent the accumulated amounts of incentive compensation reflected for financial statement reporting purposes, and therefore presumed to have been collected in rates, that exceed incentive compensation *payments* made to employees that represent a source of cost free capital to the utility. It would be a particularly inequitable outcome if the Company was permitted to earn a return on incentive compensation-related ADIT balances, but the related incentive compensation reserves, which represent a source of cost free capital to the utility, were *excluded* from rate base development. For reasons stated within an ensuing section of this report, Staff recommends that all incentive compensation costs – including rate base effects – be excluded from Missouri jurisdictional cost of service determination in this case. However, if for any reason the Commission should disagree with such Staff position, Staff would submit that both the incentive compensation-related ADIT balances (representing a rate base *addition* as proposed by Atmos) as well as the incentive compensation-related reserves (representing a larger offsetting reduction) should be considered within rate base development.

Staff has also excluded an ADIT balance related to the Company's Supplemental Executive Benefits Plan (SEBP). In another section of this report Staff's position that, at most, SEBP expense should be considered in the development of rates based on "cash" rather than on an "accrual" or actuarial expense basis. This position is consistent with Staff's position in the prior Atmos case. Inasmuch as Staff's position is that only cash expenditures for SEBP expenses should be considered in rate development, its corollary position is that all balance sheet accounts related to the SEBP should be excluded from rate base determination. Accordingly, the SEBP-related ADIT balance existing at February 28, 2010 has been excluded when developing

Staff's proposed net ADIT balance reflected within the Rate Base Summary (Accounting Schedule 2).

The SEBP-related ADIT balance that Staff has excluded in rate base development also falls into the category of ADITs that represent the payment of a tax liability by the utility *in advance* of the receipt of tax expense being recovered within customers' rates, and therefore reflects an *addition* to rate base. As was the case with incentive compensation-related ADITs, Staff again notes that while the Company *included* SEBP-related ADIT in its rate base development, it failed to reflect in rate base development the more-than-offsetting balance of the SEBP liability that is directly related to the SEBP ADIT balance. If one were to assume that actuarially-based SEBP costs have been recovered within customers' rates over the years, then it logically and consistently follows that the SEBP liability existing on Atmos' balance sheet has been funded by ratepayers, and should under that assumption, be reflected as a larger rate base *reduction.* Staff's position in the last case and in the present case is that if any SEBP costs are to be included in rates, it should be limited to cash amounts actually being paid out. Accordingly, Staff is not recommending that the SEBP liability balance existing at February 28, 2010 be reflected as a rate base reduction. However, if for any reason the Commission should disagree with Staff's recommendation to limit SEBP cost recovery to cash expenditures and move to include in Atmos' cost of service to an actuarially-based level of SEBP costs, it follows that the SEBP-related ADIT balance (as proposed by Company) *as well as the SEBP liability* should be reflected in rate base determination – with the SEBP liability balance being reflected as a larger *reduction* to rate base.

Staff also removed Post Retirement Medical Benefits-related ADITs from the development of rate base. In the prior Atmos case Staff discovered that Atmos had not been contributing Post Retirement Medical Benefits (PRMB) costs to an external trust fund, which is a requirement of Missouri Statute 386.315 to ensure rate recovery of PRMB costs. In that prior case Atmos agreed to actuarially calculate and fund a "catch-up" contribution to ensure cost recovery of actuarially-determined PRMB expense. Staff is aware that Atmos has not funded an external trust for PRMB costs for those jurisdictions that do not require contributions to an independent external trust. From Staff's perspective, Atmos *is* or *certainly should be* appropriately funding the Missouri portion of PRMB costs. The PRMB-related ADIT balance relates to that portion of Atmos' PRMB costs that are *not* being funded with an external trust. Accordingly, this ADIT balance is not properly included within the development of Missouri jurisdictional rate base. If for any reason the PRMB-related ADIT balance were to be included in rate base, it consistently follows that the related PRMB liability on Atmos' balance sheet at February 28, 2010 should also be reflected as a rate base *deduction.* Staff is not advocating such position, but notes that it would be a most inequitable outcome if Atmos were permitted to include PRMB-related ADITs in rate base but *not* be required to reflect the related PRMB liability as a rate base offset.

As itemized above, Staff also has not included a small ADIT balance, referred to as "Tax Free Interest," in its rate base development. This ADIT balance results from a timing difference, and an IRS dispute, surrounding certain tax exempt interest income. Utility investments in items other than assets employed to provide utility service are not typically included in rate base. Correspondingly, income received from investments in anything besides utility assets included in rate base is not included in cost of service development. Inasmuch as this ADIT balance is related to Atmos' non-utility investment activities, it is improper for rate base development in this proceeding.

Staff Expert/Witness: James R. Dittmer

VII. ALLOCATION OF CORPORATE COSTS

A Allocations

Atmos Energy Corporation performs its regulated services through seven regional Operating Divisions that provide regulated gas transportation and distribution services in twelve states. The seven regional Operating Divisions and their state jurisdictional service areas are:

Operating Division	**Service Territory**
Colorado-Kansas Operating Division	Colorado, Kansas, Western Missouri
Kentucky/Mid-States Division	Georgia, Illinois, Iowa, Kentucky, Eastern Missouri, Tennessee, Virginia
Louisiana Operating Division	Louisiana
Mid-Tex Operating Division	Texas, including the Dallas/Fort Worth metropolitan area
Mississippi Operating Division	Mississippi
West Texas Operating Division	West Texas
Atmos Pipeline - Texas Division	Intrastate pipeline business in Texas

A number of company-wide corporate governance and ownership functions are undertaken centrally at Atmos Energy Corporation's headquarters located in Dallas, Texas. In addition, a number of centralized functions benefiting operations company-wide are undertaken primarily at Atmos Energy Corporation's Dallas headquarters. Such functions or activities include, without limitation, accounting, gas supply, human resources, information technology, legal and customer support. Additionally, Atmos Energy Corporation maintains customer call centers in three Texas locations – Amarillo, Waco and Dallas – that support service territories in all twelve states.

Each designated Operating Division has at least one General Office that provides engineering, information technology, marketing, finance, human resource as well as other administrative support to regional service territories that are included within that Operating Division's financial reporting. Within a given state territory there may be more than one Rate Division. For instance, in Missouri there are three service territories with separately developed rates – Northeastern Missouri (NEMO), Western Missouri (WEMO) and Southeastern Missouri (SEMO) District.

In general, the various Rate Divisions have distribution operations and maintenance personnel, as well as meter readers, who work exclusively for a given Rate Division.[8] Accordingly, such dedicated personnel directly assign all of their time and related costs to the Rate Division for which they work. At the regional Operating Division level, where personnel work for numerous state territories and reporting Rate Divisions, costs are allocated to benefiting Rate Divisions via a three-factor general allocator that considers a simple average of the following components:

- Gross Directly-Assigned Property, Plant and Equipment
- Average Number of Customers
- Total Direct-Assigned O&M Expense (excluding purchased gas expense)

A factor is calculated for each Rate Division that considers a given Rate Division's data (i.e., gross plant, average number of customer, and direct-assigned O&M) as a percentage of summed identical data for all rate divisions reporting to a given regional Operating Division. A simple average of the three factors is then developed to allocate Operating Division costs to each benefiting Rate Division.

[8] Staff's understanding is that on occasion rate-division-dedicated employees may be transferred temporarily to another rate division for an event such as a storm or other natural disaster, but that in general, such employees tend to work almost exclusively for the rate division to which they are assigned.

A similar procedure is employed to allocate the cost of the majority of shared services functions and activities undertaken primarily at Atmos Energy Corporation's Dallas headquarter down to each regional Operating Division. Specifically, for central Shared Services Cost Centers – other than Customer Call Centers – the cost of the activities undertaken are allocated to benefiting Operating Divisions based upon the three-factor general allocator described above. In other words, costs incurred within Dallas Shared Services Cost Centers to undertake activities that benefit all regional Operating Divisions are allocated based upon a similar three-factor allocator that considers each regional Operating Division's plant investment, number of customers and total direct-assigned O&M. Importantly, some costs incurred within Dallas Shared Services Cost Centers benefit Atmos Energy Corporation's unregulated gas marketing operations that occur within Atmos' wholly owned subsidiary Atmos Energy Holdings, Inc. For those Cost Centers whose activities benefit Atmos Energy Holdings, Inc., a three-factor general allocator is developed which, in addition to considering the sum of all Operating Divisions' plant investment, number of customers and direct-assigned O&M, also considers such data for Atmos Energy Holdings, Inc. in order that certain centralized costs are allocated to Atmos Energy Corporation's unregulated operations. As discussed within a separate section to follow (entitled Four-factor Allocator for Certain Shared Services Cost Centers), Staff believes that the Company's three-factor general allocator fails to fairly and adequately assign certain centralized costs to Atmos' unregulated operations.

Centralized Call Center Cost are also allocated to benefiting Operating Divisions, and ultimately to benefiting Rate Divisions. However, the Call Center costs are allocated based on a factor that only considers benefiting entities' average number of customers served. For the determination of revenue requirement in this rate case, Staff supports allocating Call Center costs on the basis of average number of customers to assign such costs to benefiting Rate Divisions.

Staff Expert/Witness: James R. Dittmer

B. Reallocation of Investment and Test Year Expenses

<u>1. Update Cost Assignments for Fiscal Year 2010 Allocators</u>

Atmos Energy Corporation typically updates the factors employed to allocate Shared Services Departments and regional Operating Divisions' costs to benefiting companies and divisions at the beginning of each fiscal year. When allocating common plant and other rate base components, Atmos Energy Corporation utilized allocation factors that it began using for public financial statement presentation on October 1, 2009 – the beginning of what Atmos Energy Corporation refers to as "Fiscal Year 2010." Further, when allocating expense *adjustment amounts* Atmos Energy Corporation also employed the factors that it began utilizing on October 1, 2009. The Fiscal year 2010 allocation factors are based upon data inputs for all of Atmos Energy Corporation's companies and divisions for Fiscal Year 2009 – or data for the twelve months ending September 2009. Staff agrees that factors used to allocate common costs in this case should be those that began to be employed by Atmos Energy Corporation for public financial statement reporting purposes on October 1, 2009 – as such period clearly falls within the true-up period ending February 2010. Staff observes that while Atmos did employ Fiscal Year 2010 factors to allocate rate base components and expense *adjustment amounts*, it failed to reallocate test year recorded expenses utilizing the Fiscal Year 2010 allocation factors. When developing its test year adjusted operating expenses, Staff has reallocated test year *recorded expenses* for factors that Atmos began to use as of October 1, 2009.

2. Four-factor Allocator for Certain Shared Services Cost Centers

A summary of Atmos Energy Corporation's organizational structure and procedures for allocating common costs to benefiting entities was briefly addressed within Section VII.A. of this report entitled "Allocations." As described within the noted section, Atmos Energy Corporation has a number of Shared Services Departments that provide services to all of Atmos Energy Corporation's operations – including its unregulated marketing operations which occur within wholly owned subsidiary Atmos Energy Holdings, Inc. As also previously described, for purposes of allocating common costs Atmos Energy Corporation employs a factor that considers each benefiting entities':

- Gross Directly-Assigned Property, Plant and Equipment (Gross Direct PPE)
- Average Number of Customers
- Total Direct-Assigned O&M Expense (excluding purchased gas expense)

Staff believes use of the noted three-factor allocator to assign costs from Shared Services Departments providing services, in part, to Atmos Energy Corporation's unregulated operations is unfair to the regulated operations. Specifically, relative to its utility operations, Atmos Energy Corporation's unregulated marketing operations have very few numbers of customers and relatively little investment. For Fiscal Year 2009, Atmos Energy Corporation's unregulated operations held only 1.35% of company-wide Gross Direct PPE and had only 0.03% of company-wide average number of customers. However, Atmos Energy Corporation's unregulated operations provided 14.65% of company-wide operating income.

Some of the Shared Services Departments for which costs are allocated in part to unregulated operations undertake corporate ownership and governance functions – such as Investor Relations, Business Planning and Analysis, and Risk Management. Other common services allocated to Atmos Energy Corporation's unregulated operations include treasury functions, audit functions and corporate income taxes services. With the three-factor allocator that Atmos Energy Corporation employs, two of the three inputs – namely Gross Direct PPE and Average Number of Customers – result in a very small slice of corporate governance/ownership and executive management's costs being allocated to Atmos Energy Corporation's significant unregulated segment of operations. Staff would emphasize that a strong financial incentive exists for Atmos Energy Corporation to allocate larger portions of its common costs to *utility operations* which are rate-of-return regulated, and a smaller slice of common expenses and investments to its unregulated operations – which by definition have no actual or assumed return cap.

In light of the perceived inequities resulting from use a three-factor general allocator, Staff is proposing to allocate common Shared Services Department costs by employing a four-factor allocator. The four-factor allocator that Staff is utilizing considers the three input components already employed by Atmos, but additionally, includes the operating income of all benefiting entities. While there may be other reasonable alternatives for allocating Shared Services Department costs, Staff is proposing use of the noted four-factor allocator in this proceeding that is already employed in the state of Texas, Atmos Energy Corporation's largest state jurisdiction.

On line 4 of Schedule 6 an adjustment is posted to reflect the reallocation of test year operations and maintenance expenses utilizing a four-factor allocator that considers Fiscal Year 2009-ending data. Further, the four-factor allocator was also employed when allocating Shared Services Department investment to Missouri jurisdictional rate base, as well as to allocate applicable expense adjustments originating at the Shared Services Department level.

Staff Expert/Witness: James R. Dittmer

VIII. INCOME STATEMENT

A. Missouri Jurisdictional Rate Revenues – Accounting Schedule 5

In order to calculate Atmos' Missouri retail jurisdictional revenue deficiency (or excess), it is necessary to determine and sum all annualized and normalized Missouri jurisdictional operations and maintenance expenses, all income tax and other tax expenses, as well as annualized depreciation expense. Additionally, a return requirement is determined by multiplying a recommended weighted overall cost of capital times Atmos' Missouri retail jurisdictional investment in plant, working capital and various other investment components (i.e., rate base). The sum of all Missouri retail jurisdictional expenses and the Missouri retail jurisdictional return requirement are then compared to normalized and annualized "revenues at existing rates" to determine the Missouri retail jurisdictional base rate revenue deficiency (or excess).

Staff Expert/Witness: James R. Dittmer

1. Character of Atmos' Missouri Retail Sales

All three of Atmos' Missouri Rate Divisions serve primarily small cities or towns in rural areas. Further, the vast majority of all three Rate Divisions' sales are made to Residential and Small General Service (SGS) customers whose loads are significantly affected by weather (i.e., heating degree days). While Atmos' volumes of gas sold are significantly influenced by the weather, Atmos' base rate revenues, and ultimately its operating income, are *not* significantly impacted by weather conditions. As a result of the straight fixed variable rate design of base rates approved in Atmos' last Missouri retail rate case, Atmos collects all base tariff revenues from its two largest customer classes – the Residential and SGS classes previously noted – through a monthly customer charge. The only revenues collected through a weather sensitive volumetric charge for these two largest electric classes are for Purchased Gas Expense – which is a pass through item on customers' utility bills for which the Company neither over nor under collects costs.

Atmos also experiences seasonal fluctuations in the number of Missouri retail customers which it serves. That is to say, a number of customers disconnect service during the non-heating season, only to reconnect once the heating season begins again. Another characteristic of Atmos' Missouri Rate Divisions is that, at least for a number of years, these service territories have experienced slight, but continuous, declines in the total number of customers served. The exact losses in number of customers served from month to month are difficult to precisely observe given the number of disconnects and reconnects that occur between heating and non-heating seasons. Nonetheless, when one analyzes the number of customers served at one year intervals, or average number of customers served in annual periods, the slight but continuous loss of Residential and SGS customer is apparent.

Staff Expert/Witness: James R. Dittmer

<u>2. Calculation of Number of Residential and Commercial Small General Service Customers Permanently Lost During the Historic Test Year and Through the February 2010 Update Period</u>

Based on the Commission authorized update to the June 30, 2009-ending test year for changes in major cost of service components occurring through February 28, 2010 it is appropriate to annualize base tariff revenues considering "normalized" billing determinants associated with the number of customers taking service at the end of February 2010. Typically it is important to normalize sales for average weather conditions. While both Company and Staff have undertaken the efforts to normalize base tariff volumetric energy rates to reflect "normal" weather, such calculations have virtually no impact in calculating "revenues at existing rates" given the previously discussed straight fixed variable rate design adopted for Atmos' two largest rate classes – Residential and SGS.

If a number of Atmos' Missouri retail customers did not seasonally disconnect/reconnect natural gas service, annualization of base tariff revenues for Residential and SGS customers would involve the straight forward task of merely multiplying end-of-February 2010 number of Residential and SGS customers times twelve (to arrive at annual billing determinants) times each classes' currently-authorized monthly base tariff customer charge rate. However, in light of the previously described seasonality resulting from some customers taking service for only a portion of the year, additional calculation steps are necessary to arrive at ongoing, normalized base tariff rates associated with February 2010 customer counts for the Residential and Commercial Small General Service classes.

On the table below the number of Residential and Commercial Small General Service customers at the end of the historic test year (June 30, 2009) and at the end of the update period (February 28, 2010) are shown. Also shown on the table are the numbers of customers being served at June 30, 2008 and February 28, 2009 – twelve months prior to the end of the historic test year and twelve months prior to the cutoff period established for the update in this case. Finally, also shown on the table below are the number of customers lost for the twelve month periods ending June 30, 2009 and February 28, 2010.

continued on next page

Analysis of Residential and Commercial Small General Service Customer Declines						
Missouri Rate Division & Customer Class	Number of Customers Served at Month End				Number of Customers Lost for the 12 Months Ending	
	June 2008	February 2009	June 2009	February 2010	June 2009	February 2010
NEMO						
Residential	16,484	17,046	16,339	16,957	145	89
SGS	1,726	1,778	1,687	1,749	39	29
SEMO						
Residential	29,141	29,789	28,818	29,731	323	58
SGS	3,105	3,134	3,044	3,105	61	29
WEMO						
Residential	3,467	3,538	3,381	3,520	86	18
SGS	436	453	428	451	8	2

Source: Response to Staff Data Request Nos. 77 and 240

As previously noted, the pattern of customers disconnecting and reconnecting with the changes of the season makes the determination of actual customers *permanently* lost *by month* difficult, if not impossible, to quantify. Absent exact amounts of the number of customers permanently lost *by month* between June 2008 and June 2009, it is reasonable to assume that permanent annual losses occurred ratably throughout the twelve month period. Therefore, as part of the calculation of the adjustment to annualize revenues associated with customers taking service in February 2010, one-half of the customers lost between June 2008 and June 2009 are deducted from test year actual customer count billing determinants.

As can be observed from the table above, Atmos also lost customers between February 2009 and February 2010 (i.e., the end of the update period). Accordingly, it is appropriate to take into consideration when annualizing test year revenues for ongoing customer counts, the additional number of customers permanently lost from the end of the historic test year (June 2009) through the end of February 2010 (the update cut off period). A portion of the customers lost between February 2009 and February 2010 were lost during the historic test year, and therefore would have been considered within the first step of the customer count annualization calculation (i.e., reducing test year customer billing determinants for one half of the decline in customer counts between June 2008 and June 2009). More specifically, four of the twelve months ending February 2010 fell within the historic test year, and accordingly, it is reasonable to assume that four/twelfths of the customers lost during the twelve months ending February 2010 have already been considered in the first step of the customer count annualization process. Accordingly, when annualizing for total number of customers taking service at February 2010, only eight/twelfths (66.67%) of the customers lost between February 2008 and February 2009 is assumed to have occurred beyond the June 30, 2009-ending test year. On the table below the calculations discussed above are summarized, resulting in the total Residential and Commercial Small General Service Customer counts that are ultimately assumed to be permanently lost as of February 2010 and used within Staff's calculation of annualized base revenues associated with Residential and Commercial Small General Service customers.

Development of Customer Counts for Annualizing Residential and Commercial Small General Service Base Tariff Revenues					
	Number of Customers Lost for 12 Months Ending		Prorate Applicable to Customers Lost		Customer Count to be Deducted from TY Actual No. of Customers Billed
Missouri Rate Division & Customer Class	June 2008	February 2009	One-half of Customers Lost 12 ME June 2009	Two-thirds of Customers Lost 12 ME February 2010	
NEMO					
Residential	145	89	73	59	132
SGS	39	29	20	19	39
SEMO					
Residential	323	58	58	39	201
SGS	61	29	29	19	50
WEMO					
Residential	86	18	18	12	55
SGS	8	2	2	1	5

The Staff believes its approach to capturing the effect of the number of permanently lost customers is more accurate than the Atmos approach of adjusting the test year by an annual amount based on a three-year average of the number of Residential customers lost for the twelve month periods ending June 2007, 2008 and 2009. Such an approach overstates Residential customers lost in two ways. First, the rate at which Residential customers have been permanently lost has slowed from the earlier years included within a three-year average of Residential customers lost. Thus, the use of a three-year average, with the heavier losses in the early years, will overstate test year and post test year actual Residential customers permanently lost. Second, this methodology effectively estimates the number of customers expected to be permanently lost for the twelve months immediately following the end of the historic test year, or in other words, for the twelve months ending June 2010. Reaching to pick up customer losses through June 2010 violates the concept of attempting to true up major cost of service components through February 2010.

Staff Expert/Witness: James R. Dittmer

3. Redesign of Small General Service and Medium General Service Tariffs

Staff's positions on interclass and intraclass rate design will be addressed within testimony to be presented in this case on June 18. Nonetheless, Staff has arrived at a conclusion that the Company's proposal to begin classifying customers by meter type rather than by consumption, as occurs under existing tariffs, is reasonable. As a result of classifying customers by meter type, some current SGS customers will be shifted to the Medium General Service (MGS) rate class. However, the redefinition of tariff eligibility will result in more MGS customers being shifted to the SGS class. For all Missouri Rate Divisions, currently-effective MGS base rates are higher than currently-effective SGS rates. Therefore, the "net" migration of

MGS customers to the SGS tariff resulting from redefining tariff eligibility will result in a decline in base tariff revenues.

Because Staff intends to support the Company's redesign of eligibility for service under various tariffs, Staff's base rate revenue annualization reflected on Accounting Schedule 5 reflects revenues under "existing rates" that would occur after tariff eligibility is redefined – as proposed by Atmos and supported by Staff. Therefore, Staff's annualized "revenues at existing base rates" is approximately $470,000 *lower* than Atmos' calculated annualized "revenues at existing rates" as a result of the "net" migration of customers from high-cost tariffs to lower-cost tariffs that will occur after tariff eligibility requirements are revised. Staff expert/witness Henry Warren will be providing additional testimony regarding this migration in his testimony on June 18, 2010.

Staff Expert/Witness: James R. Dittmer

<u>4. Annualization of Base Tariff Revenues and Interaction of Staff's Base Tariff Proposal with Currently Approved Infrastructure System Replacement Surcharges</u>

Staff calculated annualized revenues, utilizing normalized customer counts at February 2010, and also by considering existing *base tariff rates.* Staff did *not* calculate the annualized impact of the Infrastructure System Replacement Surcharge (ISRS) that was in effect during the test year, nor did it calculate the annualized impact of the ISRS tariff change that became effective on March 4, 2010, when arriving at revenues *at existing permanent/base rates.* Given the ISRS in effect during the test year, customers were paying approximately $394,000 in additional annual revenues above amounts being collected within base rates. Given the new ISRS that became effective on March 4, 2010, Missouri ratepayers began paying approximately $940,000 in additional annual revenues above existing base rates. When base rates are designed within this proceeding, the ISRS that went into effect on March 4, 2010 will be rolled into base rates and the ISRS will be reset to "zero." Thus, while Staff's overall recommended Missouri jurisdictional increase in *base rates* is $4,811,781,[9] $940,434 of the calculated increase is attributable to costs currently being recovered with the March 4, 2010-effective ISRS. Accordingly, if the Commission were to adopt Staff's recommended total Missouri jurisdictional (i.e., all three rate divisions) overall base rate increase recommendation calculated at the mid-point of Staff's recommended return on equity range ($4,811,781 as shown on Accounting Schedule 1, page 1), customers would only realize or experience a total *net* annual increase of $3,871,346 as the $940,434 of costs currently being recovered in the ISRS that became effective on March 4, 2010 will no longer be collected.

As noted above, when calculating annualized revenues "at existing rates," Atmos chose to reflect annualized ISRS revenues based upon the ISRS that was in effect at the time of its original direct filing (i.e., December 2009). If Atmos had annualized just base tariff revenues as did Staff, Atmos' calculated revenue deficiency would have been approximately $394,000 higher than the revenue deficiency calculated and claimed within its filing. Staff does not perceive that there is any issue between itself and Atmos regarding ISRS revenues or the design of base rates as they related to ISRS in this proceeding. The difference is merely in the *presentation* of the calculated revenue deficiency by each party within this proceeding.

Staff Expert/Witness: James R. Dittmer

[9] As shown on page 1 of Schedule 4, Staff's recommended total Missouri jurisdictional increase in base rates, calculated by utilizing Staff's proposed mid-point of its range for return on equity, is $4,817,850.

5. Regulatory Adjustments to Test Year Sales and Rate Revenue

a. Weather Normal Variables Used for Weather Normalization

This Commission uses a "test year" to determine revenues and set appropriate rates. Natural gas usage and revenue vary from year to year based on weather conditions. Since each year's weather is unique, test-year sales need to be adjusted to "normal" weather. Climatological normal weather is characterized as an average daily temperature for each day, calculated over a 30-year period. Currently, the time period used by the Staff in determining the normal values of weather variables is the 30-year period (January 1, 1971 to December 30, 2000), which is used by the NOAA[10] and the World Meteorological Organization (WMO) to calculate normal weather variables.

Natural gas sales are predominantly influenced by ambient air temperature, so daily average temperature and the derivative measure, heating degree days (HDD), are the measures of weather used in adjusting natural gas revenues. Degree days are weather measures that were originally devised to evaluate the relationship between temperature and energy demand and consumption. Degree days are based on how far the daily average temperature (average of daily maximum and daily minimum) departs from a comfort level of 65 °F. HDDs are calculated as the number of degrees the daily average temperature is below 65 °F, and is equal to zero when the daily average temperature is above 65 °F.

To develop "normal" average temperatures and HDDs, Staff used weather records from NOAA weather stations. The three weather stations representing weather in Atmos' service area are Kansas City International Airport (MCI) for WEMO district, Kirksville Cooperative Weather Station for SEMO district and Cape Girardeau for the NEMO district.

[10] U. S. National Oceanic and Atmospheric Administration

NOAA initially calculates *monthly normal* temperature variables (such as maximum, minimum, average temperatures', HDDs) over the 30-year normals period. These monthly normals are not directly usable for Staff's purposes because NOAA's daily normals are derived by statistically fitting smooth curves through these monthly values. As a result, the published values reflect smooth transitions between seasons. For weather normalization, however, Staff must examine seasonal variability because it affects usage through the year. Consequently, Staff develops *daily normal* temperature variables by adjusting actual daily temperature data such that the average of the adjusted daily temperature variables corresponds with NOAA's normal monthly average.

Using these temperature variables Staff calculates Normal and Actual heating degree days (HDDs) to weather normalize gas usage. To determine daily normal HDDs Staff averages the adjusted daily actual HDDs for each calendar date. For example, the 30 observations of actual HDDs for January 1, of each year for the years 1971 through 2000, were averaged to determine the normal HDDs for January 1. The normal peak-day HDDs for each of the 12 months were calculated as the average of the HDDs of the coldest day in each of the 12 months.

Appendix ML-1, attached hereto as Appendix 3 presents calendar month summaries of the adjusted daily actual and normal HDDs during the test year for Atmos. This information was made available to Staff witness Kim Cox to use in calculating weather normalization adjustment factor.

Staff Expert/Witness: Manisha Lakhanpal

b. Weather Normalization of Sales

This analysis addresses the Staff's weather-normalization of natural gas sales for Atmos' customers in the Residential Class, the Small Firm General Service Class and the Medium Firm General Service Class for the test year ending June 30, 2009. Because natural gas is predominately used for space heating in Missouri, sales are dependent upon weather conditions. Since rates are based on natural gas usage, it is important to remove the influence of abnormal weather from the test year.

The Staff's weather-normalized adjustments of natural gas sales correct for deviations from normal weather conditions that have occurred during the test year. The Staff adjusted monthly natural gas volumes to normal by first equalizing each billing cycle's annual total normal heating degree days (HDDs). The Staff then added or subtracted a number of days to make each billing cycle's annual total days equal to 365. This adjustment for days sets each billing cycle to the same total number of days and normal HDDs. Once each billing cycle has the proper normal HDD, the second step is to calculate each billing cycle's difference between normal and actual HDDs. The third step is to multiply these differences times the appropriate estimate from the regression results. The fourth step is to sum each billing cycle's adjustment volumes by billing month. The fifth step is to add the monthly adjustments in thousands of cubic feet (Mcf) to the total monthly natural gas sales to calculate normalized volumes.

The Staff completed these calculations by first subdividing Atmos' billing records into three geographic regions – WEMO, SEMO and the NEMO district. Staff witness Manisha Lakhanpal provided the daily actual and daily normal HDDs for each of the three geographic regions. Ms. Lakhanpal addresses the calculation of HDDs as part of her section included in this cost of service report.

Atmos provided the Staff with monthly natural gas sales in Mcf and the corresponding number of customers for each billing cycle by customer class and geographic region for each month of the test year. The Company groups natural gas accounts into billing cycles whose meters are to be billed throughout a month. The Company bills the accounts based on the meter reading. Since there are approximately twenty (20) working days in a month, customers' accounts are usually grouped into one of the approximately twenty (20) billing cycles. Staggering the billing of customers' accounts over the billing month spreads the amount of work necessary to bill Atmos' customers. The Staff calculated two sets of twelve billing month averages by customer class for the Residential, SGS and MGS in the three geographic regions specified above. One set of these averages was the daily average natural gas usage in Mcf and another set was the daily average HDD.

These billing month averages were calculated from the data on numbers of customers, natural gas usage in Mcf, and summed HDD from approximately twenty (20) billing cycles for each billing month by customer class. Each billing month's daily average HDD in each billing cycle was weighted by the percentage of customers in that billing cycle. Thus, the billing cycles with the most customers are given more weight in computing the billing-month daily average HDD. The Staff calculated twelve monthly average-usage-per-customer amounts across the billing cycles to calculate one month's daily average usage in Mcf. The Staff's studies estimate the change in usage in Mcf related to a change in HDD. The study was based on two sets of twelve monthly billing month averages. One was the average daily usage in Mcf per customer and the other was the customer-weighted average daily HDD. These two sets of billing month averages (usage and weather) were used to study the relationship between space-heating natural gas usage in Mcf and colder weather.

The Staff used regression analyses to estimate the relationship for each of the Residential, SGS and MGS customers in each geographic region. The regression equation develops quantitative measures that describe the relationship between daily space-heating sales per customer in Mcf to the daily HDD. The regression equation estimates a change in the daily natural gas usage per customer whenever the daily average weather changes one HDD.

The Staff's analyses resulted in decreases to natural gas sales because the weather during the test year was colder than normal. The Staff's analyses resulted in an approximate decrease of .36 percent for the residential customer class for weather and cycle days. Small firm general class resulted in no adjustment for cycle days and an approximate decrease of .41 percent for weather. Medium Firm General Service Class resulted in an approximate decrease of .39 percent for weather and cycle days. (Schedules K-1 through K-6, attached hereto as Appendix 4). These results include an increase of 269,676 Mcf's for the SGS class and a decrease of 255,703 Mcf's for the MGS class for the reclassification of service. The adjustments to natural gas sales do not include the Staff's customer growth annualization.

Staff Expert/Witness: Kim Cox

6. Large Volume Service Customer Adjustments

Large Volume Service Customers normally use large quantities of gas. These customers typically could transport gas they have purchased and contract with Atmos to deliver that gas to them.

Staff reviewed Atmos' workpapers and found the Company's large customer adjustments to be reasonable.

These adjustments relate to the following classes: Large General Gas Service, Large Volume Interruptible and Large Volume Transportation. Depending on the service class, customers classified into one of the three previously stated classes can either contract with Atmos for sales of gas, or contract with Atmos to purchase their own gas which then would be delivered by Atmos. The non-gas tariffed rates for these customers are as follows:

DISTRICT	CUSTOMER CHARGE	DELIVERY/USAGE CHARGE per CCF
NEMO		
Large General Service	**$ 350**	**$0.068790**
Large Volume Interruptible	**$ 350**	**$0.068790**
Large Volume Transportation	**$ 350**	**$0.068790**
SEMO		
Large General Service	**$ 350**	**$0.09667**
Large Volume Interruptible	**$ 350**	**$0.09667**
Large Volume Transportation	**$ 350**	**$0.09667**
WEMO		
Large General Service	**$ 350**	**$0.10564**
Large Volume Interruptible	**$ 350**	**$0.10564**
Large Volume Transportation	**$ 350**	**$0.10564**

There were two types of adjustments made to the revenues of these customer classes by Atmos which Staff concurs with: Rate-Switching and Customer Gains/Losses.

Staff Expert/Witness: Thomas M. Imhoff

a. Rate Switching Adjustment

Rate –switching is a type of adjustment that is made when a customer takes service in two or more of the company's rate classes during the test year. The purpose of this adjustment is to reflect the class of service in which the customer is currently taking service. To determine the rate-switching adjustment, the customer's usage is adjusted so that all usage is counted in the customer class in which the customer was taking service at the end of the test year. These customers' usage amounts and the associated revenue are removed from the class(es) in which the customer took service during any other months; this usage is then priced out at the year-end customer class rates, and those revenues are added to that class' test year revenue.

Staff Expert/Witness: Thomas M. Imhoff

b. Customers Gains/Losses Adjustment

Customer gains/losses is another type of adjustment made to the large customers' rate revenues and this adjustment reflects the effect of customers that either began taking service on Atmos' system during the test year, or that quit taking service on the Atmos system during the test year. The purpose of this adjustment is to provide a more accurate representation of the number of customers taking service in the class. If a customer came on the system, current revenues were adjusted for the 'missing' months. If a customer dropped off the Atmos system, their revenues were removed from the current revenue calculation.

Staff Expert/Witness: Thomas M. Imhoff

c. Summary of Adjustments

The total dollar impact of all these adjustment is shown below:

NEMO

	Rate Switching	Customer Gain/Loss	TOTAL
Large General Service	$0	($45,370)	($45,370)
Large Volume Interruptible	0	0	0
Large Volume Transportation	$0	0	0
TOTAL	$0	($45,370)	($45,370)

SEMO

	Rate Switching	Customer Gain/Loss	TOTAL
Large General Service	$413	$12,445	$12,858
Large Volume Interruptible	$0	$0	$0
Large Volume Transportation	$0	$0	0
TOTAL	$413	$12,445	$12,858

WEMO

	Rate Switching	Customer Gain/Loss	TOTAL
Large General Service	$0	$0	$0
Large Volume Interruptible	$0	($4,242)	($4,242)
Large Volume Transportation	$0	$0	$0
TOTAL	$0	($4,242)	($4,242)

At this time Staff believes the adjustments made by Atmos are reasonable and does not propose any additional changes.

Staff Expert/Witness: Thomas M. Imhoff

DISTRICT CONSOLIDATION

Staff reviewed Atmos' expenses and evaluated costs from the prior rate case. These costs were similar and had small differences in their costs per customer. I reviewed Atmos' workpapers and computations to O&M costs per customer, and found them to be correctly computed. The district consolidations appear to be in line with Atmos' operations and reflect the realities of a single gas company providing gas service to its customers in each of its three geographic consolidated service areas. Atmos has been operating with three consolidated districts for the past three years. Prior to that consolidation, Atmos was providing service to the individual "legacy" operating districts for a period of about 5 years. Atmos uses the same personnel, vehicles, equipment, and call centers to provide service to customers in each current consolidated district, costing Atmos the same amount. For example, in the NEMO consolidated district, the Company's costs of service are the same, regardless of whether that service is provided to a customer in Hannibal, or to a customer in Kirksville.

Staff Expert/Witness: Thomas M. Imhoff

B. Payroll and Benefits

1. Payroll – Accounting Schedule 6 Line 5

When undertaking its analysis, Staff reviewed test year and post test year month-to-month fluctuations in the number of employees by division, as well as recent year-to-year changes in the number of employees by division. In general, Atmos' employee counts have in recent months remained fairly constant. Additionally, Staff compared test year overtime at the

Missouri Rate Divisional level to recent annual periods as well as the post test year period available during the audit. Again, in general, overtime has remained relatively constant in recent months and years. Finally, Staff also reviewed for the three Missouri Rate Divisions the percentage of labor being charged to capital versus expense within the test year relative to recent prior annual periods, as well as capital-to-expense ratios being experienced within the post test year months that were available to review. The test year percentage of payroll capitalized appeared normal relative to all periods reviewed. Given the relative stability of number of employees, overtime and expense-to-capital ratio being experienced during the test year relative to prior years as well as during the post test period time frame, test year recorded payroll expense was "annualized" for union and non-union wage increases implemented during the test year and through the update period ending February 2010 by simply prorating increases occurring during the test year and post test year period through the February 2010 cutoff. Specifically, Atmos' union employees were granted a 2.5% wage increase on June 1, 2009. Since the union increase was only effective for one of the test year months, test year union wages expensed were increased by 2.29% (11 months that the wage increase was not in effect divided by a full annual 12 month period times 2.5% equals 2.29%). Atmos' non-union employees received a 3.5% increase that became effective on October 1, 2008 (i.e., the increase was effective for nine of the twelve historic test year months). Additionally, Atmos non-union employees received a 3% increase effective October 1, 2009. Accordingly, test year non-union payroll expensed was increased by 3.88% (3/12ths times the October 1, 2008 3.5% increase plus 3.0% to reflect the annualized effect of the post test year October 1, 2009 non-union increase). Finally, related employer's payroll tax expense was correspondingly increased so as to be synchronized with the wage increases occurring within the historic test year through the February 2010 update cut off period.

Staff notes that within its “update” filing made on April 15, 2010 Atmos proposed to also reflect a *second* 3.0% non-union wage increase apparently now anticipated to become effective on October 1, 2010. However, Staff has not recognized this post true-up cut-off wage increase because it is inappropriate for consideration within this case inasmuch as it falls a full seven months beyond the end of the February 2010 update cut off.

Staff Expert/Witness: James R. Dittmer

2. Incentive Pay – Accounting Schedule 6 Line 6

Atmos offers three incentive compensation plans for its employees. A Management Incentive Plan (MIP) is offered to a select group of management employees who are responsible for directing and overseeing the day-to-day operations of the Company. The amount of MIP bonus that eligible participants may receive is dependent in part upon salary grade – with the higher salary grades becoming eligible to receive a higher MIP percentage payout. The only performance target that is determinative of whether, and to what extent, an MIP bonus will be paid is achievement of earnings per share (EPS). A “target” EPS is established, which if met, will yield a payout of 100% of the participant’s “target opportunity.” However, a “threshold” minimum EPS must be met before any MIP bonus is paid. If only the “threshold” minimum EPS is met, participants will only receive 50% of their “target opportunity” amount. Finally, if Atmos’ actual achieved EPS exceeds the “target” EPS amount, participant may receive additional MIP bonus amounts above the “target” payout – never to exceed a maximum of 200% of the “target opportunity” amount.

A Variable Pay Plan (VPP) is offered to virtually all employees except those who are eligible for the MIP. The targeted VPP is two percent (2.0%) of all employees' base compensation – which includes base salary plus overtime and premium pay. Like the MIP, the VPP performance target is exclusively EPS achievement. Further, like the MIP, the VPP payout can be lower or higher than the targeted two percent (2.0%) payout –depending upon the extent to which achieved EPS is lower or higher than the targeted EPS. If only the "threshold" minimum EPS is achieved, VPP-eligible employees will receive only one percent (1.0%) of base compensation. Conversely, if actual EPS exceed the target EPS, eligible employees can receive in excess of the two percent (2.0%) target – up to a maximum of three percent (3.0%).

An equity-based Long Term Incentive Plan (LTIP) is offered to a more limited number of upper management employees and officers. Compensation under the LTIP comes in the form of 1) time-lapse restricted shares of Atmos stock and 2) performance-based restricted share units. The time-lapse restricted shares awarded under the LTIP are subject to a three-year restricted vesting period. The performance-based restricted share units must be earned over a three-year performance period with the number of shares earned being determined by Atmos' cumulative three-year achieved EPS relative to the planned or targeted level of EPS for the same period.

Staff recommends that all of the test year costs associated with all of the three incentive compensation plans be eliminated from development of Atmos' Missouri retail jurisdictional cost of service. Specifically, Staff believes that earnings-driven incentive compensation plans are not consistent with, or certainly not entirely consistent with, the interests of utility customers. Earnings can sometimes be achieved or influenced by short term management decisions that, while temporarily boosting earnings, may not encourage the development of safe and reliable service at the lowest long term achievable costs.

Staff also notes that earnings can be influenced by events that are often beyond the control of management – such as weather, gains/losses in customer, or changes in taxes assessed. Finally, Staff notes that a significant portion of Atmos' earnings per share is derived from Atmos' unregulated marketing activities. Staff would submit that it is simply poor regulatory policy to allow for recovery in rates the cost of incentive compensation plans that are earnings driven (which are sometimes impacted by events/conditions beyond management's control), and particularly inappropriate when the utility's total earnings per share is impacted by unregulated subsidiaries' operating income. Accordingly, as reflected on Accounting Schedule 6, line 6, Staff is proposing to disallow the total cost of all three incentive compensation plans charged to expense during the historic test year.

Staff Expert/Witness: James R. Dittmer

<u>3. Other Employee Benefits – Accounting Schedule 6 Line 7</u>

On Accounting Schedule 6, line 7, test year employee benefits expenses are adjusted to reflect annualized employee benefits costs develop utilizing loading rates in effect for Fiscal Year 2010.[11] The employee benefits loading rate for Fiscal Year 2010 are only very slightly higher than the employee benefits loading rate in effect for Fiscal Year 2009. However, the reason that the adjustment shown on line 7 of Accounting Schedule 6 for the sum of all three Missouri Rate Divisions reflects a small *reduction* to test year recorded employee benefits expense stems from an accounting error recorded during the historic test year which overstated employee benefits expense charged to the WEMO Rate Division. Accordingly, the adjustment shown on Accounting Schedule 6 not only annualizes employee benefits expense for the slightly

[11] Thus, Atmos' Fiscal Year 2010 began October 1, 2009 and will end on September 30, 2010.

higher employee benefits loading rates effective in Fiscal Year 2010, it additionally corrects for the overstatement of expense occurring during the historic test year for the WEMO Division.

Staff Expert/Witness: James R. Dittmer

4. Supplemental Employee Benefits Plan Expenses – Accounting Schedule 6 Line 8

As previously noted, Atmos maintains a Supplemental Executive Benefits Plan (SEBP) for selected officers which provides for retirement benefits beyond that offered in the Company's qualified defined pension benefit plan. As in the prior Atmos case, Staff is recommending that if SEBP costs are included in rate development, at most such cost recovery should be limited to actual payouts. Accordingly, Staff has developed a three-year average of SEBP payouts and included such amount on a Missouri-allocated basis within its revenue requirement recommendation.

In addition to reflecting cash-basis SEBP costs in its revenue requirement recommendation, Staff also removed a non-recurring impairment charge related to Atmos' SEBP that was recorded within the historic test year. Atmos does not have an external trust established for the payment of SEBP payments as exists for Atmos' qualified traditional defined benefits plan. However, it has established a Rabbi Trust, which it controls and reflects on its balance sheet for financial statement reporting, for the purpose of eventually paying SEBP benefits. During the test year Atmos was required to reflect as an operating expense a fairly significant "impairment" in Rabbi Trust fund assets which Staff does not believe has previously occurred, and in any event, certainly does not consider a "recurring" event proper for rate development. Staff's position is that Atmos should, at most, be allowed recovery of SEBP costs on a cash basis, and accordingly, losses of the Rabbi Trust should not be included in rate development. But even assuming the Commission was to allow Atmos to recover actuarially-based SEBP costs, the non-recurring impairment charge related to the Rabbi Trust should be excluded from rate development in this case.

Staff Expert/Witness: James R. Dittmer

C. Other Non-Labor Expenses

<u>1. Bad Debts Expense – Accounting Schedule 6 Line 9</u>

On Accounting Schedule 6, line 9, Staff reflects an adjustment to normalize test year bad debt expense based upon a three-year average of net-write offs experienced for the twelve month periods ending February 2008, 2009 and 2010. This is the same methodology that Atmos has proposed within its February 2010-ending update filed on April 15, 2010.

Staff Expert/Witness: James R. Dittmer

<u>2. Non-recurring Environmental Expense – Accounting Schedule 6 Line 10</u>

The adjustment reflected on line 10 of Accounting Schedule 6 eliminates test year expenses incurred to clean up the former Hannibal Manufactured Gas Plant. The Company has acknowledged that these expenses are expected to be non-recurring and therefore are not reflective of the ongoing cost of service.

Staff Expert/Witness: James R. Dittmer

<u>3. Advertising and Promotional Expenses – Accounting Schedule 6 Line 11</u>

In preparing its calculated revenue deficiency, Atmos identified certain advertising and promotional expenditures that it recognized as inappropriate for rate recovery. In addition to eliminating these advertising and promotional expenditures, Staff identified certain other charges that were determined to be inappropriate for rate recovery. The advertising and promotional expenditures that Staff has excluded from test year expenses, which are incremental to those identified and voluntarily eliminated by Atmos, include the following:

- Staff has excluded the test year costs incurred with the events marketing firm Excel Meeting and Events. Excel Meetings and Events was paid $212,251 dollars during the test year to inspect sites of venues, negotiate contracts with hotels/transportation vendors/caterers and meeting facilities related to the Company's Annual Meeting of Shareholders and Board of Directors off-site sessions with senior management. While it is necessary to hold Board of Directors meetings, Staff observes no ratepayer value in holding elaborate off-site meetings.
- Staff eliminated 57% of the test year costs incurred with the RBMM Advertising Agency (RBMM). RBMM provided design, production and media purchasing for Atmos. Staff reviewed the seven RBMM sample work products provided by Atmos and determined that four of the seven ads developed or designed by RBMM were either promotional or image building in nature. The examples of ad copy provided that Staff determined to be promotional/image building have been affixed as Appendix 5 (JRD 1 of 4) to this Staff Report. Finding four of the seven work products provided by Atmos to be inappropriate for rate recovery, Staff is proposing to eliminate 4/7ths – or 57% - of test year RBMM costs allocated to Missouri Rate Divisions. Staff's position to eliminate advertising that is promotional or image building in nature, is consistent with Commission precedent on this topic.

- Staff eliminated the Missouri-allocated portion of an ad which Atmos ran in the Dallas Regional Chamber's Economic Development Directory. The ad run was simply image building in nature, and accordingly, should be eliminated from cost of service development.

Through discovery submitted in this issue area, Atmos provided a listing of costs that had been inadvertently and inappropriately charged the Mid-States Operating Division that should have been direct charged exclusively to a non-Missouri rate division. Conversely, the Company also identified certain costs that were charged during the test year to the Mid-States Operating Division and only allocated in part to the Missouri Rate Divisions that should have been charged entirely to Missouri Rate Divisions. Such recording errors have also been reflected in the development of the adjustment for promotional expenses shown on line 11 Accounting Schedule 6.

Staff Expert/Witness: James R. Dittmer

4. Club Dues and Membership Fees – Accounting Schedule 6 Line 12

When preparing its adjusted test year cost of service, Atmos also identified a number of club dues and organization membership fees that "could be deemed as questionable expenses." (Mr. Robert Hassen direct testimony, page 6). In addition to the club dues and membership fees that Atmos identified and voluntarily eliminated from cost of service development, Staff identified additional or incremental dues and fees charged to expense during the historic test year that it submits are unnecessary – or that have not been demonstrated to be necessary - to incur to provide safe, reliable and efficient natural gas distribution service. Additional club dues and membership fees, above those identified by Atmos for cost of service exclusion, include:

- The costs charged to the Mid-States Operating Division, which were in turn allocated in part to Missouri Rate Divisions, which represent payments to the Kentucky Association of Manufacturers. Atmos responded to Staff Data Request No. 330 that such costs should have been charged exclusively to Kentucky rate divisions.
- 50% of the cost of membership dues paid to the American Gas Association (AGA). The AGA promotes and encourages the sharing of information designed to achieve operational excellence by improving local gas distribution companies' safety, security, reliability, efficiency, environmental and other performance metrics. However, the AGA also focuses on promoting natural gas usage as well as advocating legislative changes affecting members' operations. The National Association of Regulatory Utility Commissioners Committee on Utility Association Oversight completed an AGA audit in 2000 that indicates that approximately 50% of AGA costs are promotional or legislative-influencing in nature. The noted audit is the last one that Staff is aware of that independently attempted to categorize and quantify the efforts of the AGA. Inasmuch as Staff submits that the costs for "promotional" as well as "lobbying" efforts are not properly recoverable from ratepayers, Staff has eliminated 50% of AGA costs as being attributable to such below-the-line activities.
- Staff has eliminated 50% of the cost of membership dues paid to the Southern Gas Association (SGA). SGA provides its members with training, conferences and seminars addressing issues important to the natural gas industry. Many of the

activities and events undertaken by SGA for its members are viewed by Staff to be designed to facilitate safe, efficient natural gas distribution service. That stated, Staff views a portion SGA's purpose to be to promote natural gas usage over alternative energy sources, as well as to undertake activities that are designed to influence legislation impacting the industry. Inasmuch as Staff submits that the costs for "promotional" as well as "lobbying" efforts are not properly recoverable from ratepayers, Staff has eliminated 50% of SGA costs as being attributable to such activities.

- Atmos voluntarily eliminated the costs of membership fees to the Chamber of Commerce of a number of communities within its service territories. Staff has eliminate remaining membership fees paid to the Chamber of Commerce of other communities that Atmos did not identify and eliminate from test year cost of service development. Additionally, Staff has eliminated the Missouri- allocated portion of a $50,000 fee paid to the Dallas Regional Chamber.
- Staff eliminated the Missouri-allocated portion of fees paid to the Texas Association of Appraisal Districts (TAAD). TAAD is a statewide voluntary non-profit organization incorporated and organized to promote the effective and efficient functioning and administration of appraisal districts in Texas. While membership in such organization may provide some slight benefit to Missouri retail ratepayers – given that property taxes on the call centers and other shared services units located in Texas are allocated in small part to Missouri rate payers – Staff submits that the larger beneficiaries of membership to such an organization would likely be the numerous large retail rate districts located in

Texas that pay significant amounts of property tax on local gas distribution systems operating in Texas.

- Staff eliminated reimbursements to employees for memberships in civic organizations such as Rotary Clubs, Lion Clubs and Kiwanis Clubs. It is possible that some of the reimbursements eliminated may be for professional organizations that may be properly includable in cost of service development. If the Company is inclined to provide a break out of reimbursements of the 100-plus reimbursements that were for fees paid to legitimate professional organizations, this Staff adjustment could be revised accordingly.
- Atmos eliminated a number of employee expense reimbursements that were unexplained. Staff eliminated additional employee expense reimbursements that were not explained.

Staff Expert/Witness: James R. Dittmer

5. Miscellaneous Employee Expenses – Accounting Schedules 6 Line 13

Atmos also identified a number of employee expenses that it determined to be inappropriate for cost of service development. Such company-identified employee expenses that Atmos determined to be improper for cost of service inclusion have been reflected in an adjustment shown on line 13 of Accounting Schedule 6.

Staff Expert/Witness: James R. Dittmer

6. Miscellaneous Employee Expense Reports – Accounting Schedule 6 Line 14

Atmos also identified a number employee expense reimbursements for social events, alcohol, spousal travel and "any other expenses that may be questionable in nature." (Mr. Robert

Hassen direct testimony, page 6) Shown on line 14 of Accounting Schedule 6 are the employee expense report disallowances self-reported by Atmos.

Staff Expert/Witness: James R. Dittmer

7. Postage Expense – Accounting Schedule 6 Line 15

In early May 2009 the United States Postal Service implemented an increase in postage costs. On line 15 of Accounting Schedule 6 an adjustment is reflected to capture the expense impact of the noted postal increase. The Staff's postage expense adjustment has been synchronized with the customer counts it has reflected within its revenue annualization adjustment.

Staff Expert/Witness: James R. Dittmer

8. Rate Case Expenses – Accounting Schedule 6 Line 16

Atmos has estimated total rate case expense for this proceeding in the amount of $285,000, which it proposes to amortize over three years. In the prior Atmos rate case, which was partially settled but still resulted in hearings and appeals, Atmos incurred approximately $320,000 in rate case expense. Staff has accepted and incorporated within an adjustment reflected on line 16 Accounting Schedule 6 the Company's proposed total rate case expense estimate ($285,000), as well as the Company-proposed three-year amortization period. If this case settles it would be reasonable to include a lower total rate case expense amount in the development of any agreed upon rate increase to reflect the savings realized from avoidance of formal hearings and preparation of legal briefs.

The Staff has also removed the rate case amortization expense related to Atmos' last rate case that was recorded within the historic test year – and which has expired subsequent to the end of the historic test year. Unless the prior case rate case amortization expense is eliminated from test year operating results, rates being developed in this proceeding will include rate case amortization costs for the prior as well as current rate case. When developing Staff's rate case expense adjustment reflected on line 16 of Accounting Schedule 6, Staff appropriately deducted from the proforma level of rate case amortization expense which it is proposing for this case the expiring level of rate case amortization expense from the prior case that was recorded during the historic test year to arrive at a small net *reduction* in test year recorded rate case amortization expense. The Company, in its response to Staff Data Request No 239, effectively conceded that removing such expenses in this proceeding is appropriate.[12]

Staff Expert/Witness: James R. Dittmer

9. Governmental Affairs Costs – Accounting Schedule 6 Line 17

Staff proposes an adjustment to disallow one-half of the Missouri-allocated portion of the cost of the Governmental Affairs Shared Services Department on the grounds that a significant portion of that department's efforts relate to public image building and lobbying activities. The "Basic Function" given for the two highest ranking employees of the noted department – namely, the Vice President, Government & Public Affairs and the Director of Government & Public Affairs – includes the following:

> Provides executive leadership and is fully responsible for results delivered by the Company's governmental, public affairs and corporate communications function to enhance the public image of the Company and to ensure regulatory compliance.
>
> Directs, organizes and coordinates the Company's political and public activities in regards to state and local political areas as well as manages the public relations to create and enhance a favorable business environment. (Response to Staff Data Request No. 230)

[12] When responding to Staff Data Request No. 239 Atmos first provided the amount of prior case amortization expense recorded within the historic test year. The Company went on to state in relevant part that "the Company would not object to this specific amortization being excluded in this proceeding assuming that all parties agree that costs in the current proceeding are specifically addressed and authorized for recovery."

Arguably a portion of the department's costs incurred for organizing and implementing activities such as communications programs designed to inform customers, Board of Directors and customers of issues affecting such stakeholders is proper for cost of service development. However, clearly a significant portion of this department's efforts are devoted to legislative activities and "image building" which this Commission has routinely disallowed. Accordingly, the adjustment found on line 17 of Schedule 6 is proposed to eliminate one-half of this department's cost as improper for inclusion in the development of retail rates.

Staff Expert/Witness: James R. Dittmer

10. Customer Deposit Interest Expense

See the discussion in Section VI.I., Rate Base - Customer Advances and Customer Deposits.

11. Energy Efficiency and Conservation Programs

As a result of the Commission's Report and Order in Case No. GR-2006-0387, the Company was to contribute 1% of its annual gross non-gas revenues toward programs designed to promote energy conservation, efficiency, and education. Atmos tariff sheets 112 – 119, authorized subsequent the last rate case and updated in October 2009, describe the programs that have been implemented to meet this requirement. The programs include weatherization for qualified low income customers, rebates for residential and small commercial customers purchasing high efficiency space heating and water heating equipment, and customer education. Table 1 below appeared in the Company's annual report at the end of the second program year, filed with the Commission on December 29, 2009. The table summarizes the allocations and expenditures on weatherization of low-income customers, rebates on high efficiency equipment, and customer education. As can be seen the Company contributed $165,000 for Program Year 2007 (September 2007 – June 2008) and $172,775 Program Year 2008 (June 2008 – July 2009).

Table 1: Atmos Allocations and Expenditures on Energy Efficiency and Education*

	Rebates			Weatherization			Customer Education		
Program Year	*Allocation*	*Expended*	*Rebates Issued*	*Allocation*	*Expended*	*Homes Weatherized*	*Allocation*	*Expended*	*Schools Served*
2007	$60,000	$11,500	46	$100,000	$16,859	12	$5,000	$2,282	3
2008	60,000	21,250	85	100,000	133,766	57	12,775	5,112	9
Totals	$120,000	$32,750	131	$200,000	$150,625	69	$17,775	$7,394	12

**From the Annual Report of Atmos Energy Corporation Regarding the Company's Fixed Delivery Charge Rate Design and Its Impact on Energy Efficiency and Conservation, filed in Case No. GR-2006-0387, December 29, 2009 (p. 2).*

Of the total allocation of $337,775 for the two year period, $190,769 has been expended, and $147,006 remains unexpended. One reason for the shortfall in expenditures is the shortened 2007 Program Year. In particular some of the 2007 shortfall in the largest expenditure, low income weatherization, was made up in 2008. However, there is still a substantial shortfall in expenditures.

Staff proposes that the Company should continue to develop and implement programs that include weatherization for low-income customers, energy efficiency for residential and commercial customers, and customer education. The collaborative established in the previous rate case to advise Atmos on the development and/or modification of energy efficiency and education programs should be continued. The rebates for energy efficient equipment should be extended to Medium Firm General Service, Large Firm General Service, and Large Volume Gas Service customers. A regulatory asset account should be established for expenditures on these programs beginning with implementation of rates in the current case. The unexpended allocated balance of $147,006, updated for current allocations and expenditures at the date rates from the current case are implemented, should be credited to the regulatory asset account and offset future expenditures accumulated in the account. The budgeted expenditures of 1% of annual non-gas revenues updated to Staff's adjusted non-gas revenues in the current rate case, $19,807,668, would yield $198,077 of annual expenditures. The regulatory treatment of the amounts accumulated in the regulatory asset account and the associated recovery period will be determined in Atmos' next general rate case.

Staff Expert/Witness: Henry Warren

12. Commission Assessment Assessment – Accounting Schedule 7 Line 41

On July 24, 2009 Atmos as well as other utilities regulated by this Commission received notice of the Commission's assessment fee to be in effect for fiscal year commencing July 1, 2009. Atmos' Commission fee assessment for the fiscal year beginning July 1, 2009 was slightly lower than the assessment it received for the fiscal year beginning July 1, 2008 – and which was recorded as "other tax" expense during the historic test year. Accordingly, also shown on Accounting Schedule 7 at lines 38 through 41 is a small downward adjustment to reflect lower Commission assessment fees that are currently in effect for the period July 1, 2009 through June 30, 2010.

During the historic test year Atmos charged all Commission assessment fees to the NEMO Rate Division. It would be inequitable to charge 100% of the Commission assessment fee that is determined by considering all three Missouri Rate Divisions' revenues to only the NEMO Rate Division. Accordingly, in addition to reflecting the slightly lower Commission assessment fee currently in effect, the adjustment shown on Accounting Schedule 7 allocates the current Commission assessment fee to all Missouri Rate Divisions on the basis of annualized base tariff revenues.

Staff Expert/Witness: James R. Dittmer

D. Taxes - Other

<u>1. Ad Valorem (Property) Taxes – Accounting Schedule 7 Line 22</u>

When preparing its "update" to reflect changes in major cost of service components through February 2010, Atmos proposed to adjust test year recorded ad valorem expense accruals for last known ad valorem taxes "paid" during and subsequent to the June 30, 2009-ending test year. Staff verified actual payment amounts reflected within the Company's "update" adjustment. On line 22 of Accounting Schedule 7 Staff posts an ad valorem tax adjustment to reflect last known "paid" amounts that is identical to the ad valorem tax adjustment that Atmos reflected within its "update" filing.

Staff Expert/Witness: James R. Dittmer

<u>2. Payroll Taxes – Accounting Schedule 7 Line 36</u>

Also reflected on Accounting Schedule 7 is an adjustment to test year recorded payroll tax expense to reflect the Staff's payroll wage-increase annualization adjustment. As reflected on lines 33 through 36, a composite payroll tax rate was applied to the Staff's wage adjustment reflected on line 5 of Accounting Schedule 6 to arrive at a small net increase in recorded test year employer's payroll tax expense. Staff's payroll tax expense adjustment is identical in concept to that proposed by the Company, but has been synchronized with Staff's proposed proforma level of payroll expense.

Staff Expert/Witness: James R. Dittmer

E. Depreciation Expense – Accounting Schedule 8

Staff annualized depreciation expense by applying currently-authorized depreciation rates times the February 28, 2010 plant in service balances. It is noted that in Atmos' prior rate case (GR-2006-0387) the Company and Staff agreed that depreciation expense had been over accrued, and that it would be appropriate to reflect in the development rates being established in that proceeding a negative amortization of the depreciation reserve in the annual amount of $591,000. This Commission adopted the Staff/Company stipulation to reflect negative amortization expense agreed upon.

In Case No. GE-2009-0443 filed last summer Atmos sought a waiver to file a new depreciation rate study in this general rate case. In that proceeding, Atmos and the OPC agreed to waive the requirement to file a new depreciation rate study in this case, and further agreed that Atmos was to remove the negative amortization authorized in Case No. GR-2006-0387 when preparing its cost of service in this case. The noted Atmos/OPC stipulation from Case No. GE-2009-0443 was approved by this Commission on September 16, 2009.

The adjustment calculated on Accounting Schedule 9 reflects an increase to test year recorded depreciation expense in the amount of $811,851, of which $591,000 relates to the stipulation reached in Case No. GE-2009-0443.

Staff Expert/Witness: James R. Dittmer

F. Income Tax Expense – Accounting Schedule 9

The Staff's calculation of total cost of service income tax expense under existing rates is reflected on Accounting Schedule 9. Given that Atmos is authorized full "tax normalization" accounting, the total amount of income tax expense to be calculated for cost of service development at existing rates is primarily, though not exclusively, a product of the utility's before-tax net income. Specifically, in order to calculate income tax expense for cost of service development at existing rates, one must deduct (or add as the facts dictate) any ongoing "permanent" book/tax differences from the Company's "as adjusted" net income under existing rates.

As shown on line 18 of Accounting Schedule 9, Staff has identified one permanent book/tax difference related to Missouri jurisdictional operation that is appropriate for inclusion in cost of service income tax development. Specifically, employees can purchase company stock within their self-directed 401-k accounts. The dividends paid on company stock held inside employees' 401-k accounts is deductible for federal and state income taxes, while it is simply an element of shareholder return for financial statement reporting and cost of service development purposes. Inasmuch as Missouri ratepayers are paying the dividends on the Atmos stock held within employees' 401-k plans vis-à-vis the inclusion of a targeted return on equity included in cost of service development, it logically and consistently follows that the 401-k dividend deduction available to Atmos should be considered in cost of service income tax development.

The composite federal and state income tax rate for Atmos' Missouri operations is 38.3887%. The composite federal and state rates is developed by considering the current corporate federal income tax rate of 35% and the current corporate Missouri state income tax rate of 6.25% and the cross deductibility of these taxes[13].

As shown on Accounting Schedule 9, Staff has calculated income tax expense under existing rates by applying the noted composite federal/state income tax rate to Atmos' Missouri jurisdictional operating income before taxes, less interest expense synchronized with Staff's recommended rate base and cost of capital recommendation, as well as the Missouri-allocated portion of the noted permanent book/tax differences resulting from dividends paid on Company stock held within the Company's 401-k plan.

Staff Expert/Witness: James R. Dittmer

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[13] State income taxes are fully deductible for purposes of calculating federal taxable income, while 50% of federal income taxes payable are deductible for purposes of calculating Missouri state taxable income. Staff notes that Atmos developed a composite federal/state income tax rate that failed to recognize that 50% of federal income taxes paid are deductible for purposes of calculating Missouri state taxable income.

APPENDICES

Appendix 1 - Staff Credentials

Appendix 2 - Support for Staff Cost of Capital Recommendation - Zephania Marevangepo

Appendix 3 - Weather Normal Variables Used for Weather Normalization - Manisha Lakhanpal

Appendix 4 - Weather Normalization of Sales - Kim Cox

Appendix 5 - Advertising and Promotional Expenses - James R. Dittmer

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Atmos Energy Corporation's Tariff Revision Designed to Implement a General Rate Increase for Natural Gas Service in the Missouri Service Area of the Company.	))))	Case No. GR-2010-0192

AFFIDAVIT OF KIM COX

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Kim Cox, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Staff Report in pages 57 - 59; that she has knowledge of the matters set forth in such Report; and that such matters are true to the best of her knowledge and belief.

Kim Cox
Kim Cox

Subscribed and sworn to before me this 1st day of June, 2010.

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

SUSAN L. SUNDERMEYER
My Commission Expires
September 21, 2010
Callaway County
Commission #06942086

Susan L Sundermeyer
Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Atmos Energy Corporation's Tariff Revision Designed to Implement a General Rate Increase for Natural Gas Service in the Missouri Service Area of the Company.	))))	Case No. GR-2010-0192

AFFIDAVIT OF JAMES R. DITTMER

STATE OF MISSOURI)
) ss.
COUNTY OF ~~COLE~~ JACKSON)

James R. Dittmer, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Staff Report in pages 23-54, 62-76 and 78-81; that he has knowledge of the matters set forth in such Report; and that such matters are true to the best of his knowledge and belief.

James R. Dittmer

James R. Dittmer

Subscribed and sworn to before me this 27th day of MAY, 2010.

Kathleen Morgan

Notary Public

KATHLEEN MORGAN
Notary Public - Notary Seal
State of Missouri, Jackson County
Commission # 08417145
My Commission Expires May 21, 2012

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Atmos Energy Corporation's Tariff Revision Designed to Implement a General Rate Increase for Natural Gas Service in the Missouri Service Area of the Company.	))))	Case No. GR-2010-0192

AFFIDAVIT OF THOMAS M. IMHOFF

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Thomas M. Imhoff, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Staff Report in pages 59-62; that he has knowledge of the matters set forth in such Report; and that such matters are true to the best of his knowledge and belief.

Thomas M. Imhoff
Thomas M. Imhoff

Subscribed and sworn to before me this 2nd day of June, 2010.

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

SUSAN L. SUNDERMEYER
My Commission Expires
September 21, 2010
Callaway County
Commission #06942086

Susan L. Sundermeyer
Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Atmos Energy Corporation's Tariff Revision Designed to Implement a General Rate Increase for Natural Gas Service in the Missouri Service Area of the Company.	))))	Case No. GR-2010-0192

AFFIDAVIT OF MANISHA LAKHANPAL

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Manisha Lakhanpal, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Staff Report in pages 55 and 56; that she has knowledge of the matters set forth in such Report; and that such matters are true to the best of her knowledge and belief.

Manisha Lakhanpal

Manisha Lakhanpal

Subscribed and sworn to before me this 4th day of June, 2010.

Nikki Senn

Notary Public

NIKKI SENN
Notary Public - Notary Seal
State of Missouri
Commissioned for Osage County
My Commission Expires: October 01, 2011
Commission Number: 07287016

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Atmos Energy Corporation's Tariff Revision Designed to Implement a General Rate Increase for Natural Gas Service in the Missouri Service Area of the Company.	))))	Case No. GR-2010-0192

AFFIDAVIT OF ZEPHANIA MAREVANGEPO

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Zephania Marevangepo, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Staff Report in pages 5 - 23; that he has knowledge of the matters set forth in such Report; and that such matters are true to the best of his knowledge and belief.

Zephania Marevangepo

Subscribed and sworn to before me this 4th day of June, 2010.

NIKKI SENN
Notary Public - Notary Seal
State of Missouri
Commissioned for Osage County
My Commission Expires: October 01, 2011
Commission Number: 07287016

Nikki Senn
Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Atmos Energy Corporation's Tariff Revision Designed to Implement a General Rate Increase for Natural Gas Service in the Missouri Service Area of the Company.	))))	Case No. GR-2010-0192

AFFIDAVIT OF STEPHEN M. RACKERS

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Stephen M. Rackers, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Staff Report in pages 1-5; that he has knowledge of the matters set forth in such Report; and that such matters are true to the best of his knowledge and belief.

Stephen M. Rackers

Stephen M. Rackers

Subscribed and sworn to before me this 4th day of June, 2010.

NIKKI SENN
Notary Public - Notary Seal
State of Missouri
Commissioned for Osage County
My Commission Expires: October 01, 2011
Commission Number: 07287016

Nikki Senn

Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Atmos Energy Corporation's Tariff Revision Designed to Implement a General Rate Increase for Natural Gas Service in the Missouri Service Area of the Company.	))))	Case No. GR-2010-0192

AFFIDAVIT OF HENRY E. WARREN, PHD

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Henry E. Warren, PhD, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Staff Report in pages 76-78; that he has knowledge of the matters set forth in such Report; and that such matters are true to the best of his knowledge and belief.

Henry E. Warren

Henry E. Warren, PhD

Subscribed and sworn to before me this 4th day of June, 2010.

NIKKI SENN
Notary Public - Notary Seal
State of Missouri
Commissioned for Osage County
My Commission Expires: October 01, 2011
Commission Number: 07287016

Nikki Senn

Notary Public