

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

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PUBLIC SERVICE  
COMMISSION

OFFICE OF THE ATTORNEY GENERAL )  
COMMONWEALTH OF KENTUCKY )  
V. )  
ATMOS ENERGY CORPORATION )

Case No. 2005-00057

**Answer of Atmos Energy Corporation**

Atmos Energy Corporation, by counsel, pursuant to the Commission's order of February 4, 2005, files its answer to the proffered Complaint of the Attorney General.

807 KAR 5:001(12) states in part :

Formal Complaints. (1) Contents of complaint. Each complaint shall be headed "Before the Public Service Commission," shall set out the names of the complainant and the name of the defendant, and shall state: . . .

(c) Fully, clearly, and with reasonable certainty, the act or thing done or omitted to be done, of which complaint is made, with a reference, where practicable, to the law, order, or section, and subsections, of which a violation is claimed, and such other matters, or facts, if any, as may be necessary to acquaint the commission fully with the details of the alleged violation. The complainant shall set forth definitely the exact relief which is desired (see Section 15(1) of this administrative regulation).

4) Procedure on filing of complaint.

(a) Upon the filing of such complaint, the commission will immediately examine the same to ascertain whether it establishes a prima facie case and conforms to this administrative regulation. If the commission is of the opinion that the complaint does not establish a prima facie case or does not conform to this administrative regulation, it will notify the complainant

or his attorney to that effect, and opportunity may be given to amend the complaint within a specified time. If the complaint is not so amended within such time or such extension thereof as the commission, for good cause shown, may grant, it will be dismissed.

The Complaint submitted by the Attorney General fails to comply with the requirements of the regulation. The allegation made is that Atmos' rates are unfair, unjust and unreasonable because of certain unspecified changes in "economic conditions and "substantial reductions in interest rates." There is no fact presented that meets the regulations standard for "reasonable certainty" of a violation by Atmos nor has an "act or thing done or omitted" to be done identified. Further, no order, statute, or regulation is cited that has been violated. The thrust of the Complaint is that in the Attorney General's opinion, the rates being charged are excessive. The rates being charged are those authorized by the Commission. There is no allegation to the contrary.

In fact, the testimony submitted with the Complaint admits the lack of specific relevant information in the possession of the Attorney General to support his speculation. On page two of Mr. Henkes' testimony, he states that he conducted a "limited earnings review" based on seven documents, three of which involve non-Kentucky companies and a third involving an unrelated Kentucky gas utility. There is no attempt made to show any relevance of this unrelated information to Atmos' earnings. Unsubstantiated assertions with reference to irrelevant information are not adequate to meet the prima facie standard of the regulation.

Indeed, Mr. Henkes concedes that his analysis is faulty. On page five of his testimony, he qualifies his conclusions by noting that his calculations have not been adjusted for Kentucky ratemaking principles.<sup>1</sup> His analysis is also based on a misunderstanding or misstatement of a similar complaint by the Tennessee Attorney General before the Tennessee Regulatory Authority. On page 8 of his testimony, he refers to Atmos' over earnings in Tennessee. In reality, there has been no finding by the TRA of any over earnings by Atmos as a result of that complaint or otherwise. In fact, the TRA has not yet even addressed the Petition filed with it regarding Atmos' earnings in Tennessee.

Mr. Henkes, also without any justification, assumes a "benchmark" return on equity of 10.50%. He makes no effort to explain how this is derived or how it is relevant to the specific financial condition of Atmos. He does provide a schedule with various returns on equity with his testimony. However, that schedule includes a water utility and four electric utilities. No explanation of the relevance of those companies to Atmos is given. There is also no explanation of why those types of utilities are relevant to the calculation of a gas utilities' return or whether the Commission has relied on those utilities to set Atmos' return in prior cases.

The burden of proof in this matter is on the complainant. See for example *Earnest Miller v. Hima-Sibert Water District*, Case No. 95-228 (January 16, 1996), in which the Commission said: "Applicants before an administrative agency have

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<sup>1</sup> While admitting that his Kentucky specific information is unreliable, he fails to even acknowledge that the order from Colorado or the Complaint filed in Tennessee are based on regulatory standards that may not be comparable to those in Kentucky. Without such comparability, they are of no significance in the Commission's review of the allegations made in this Complaint.

the burden of proof. Energy Regulatory Commission v. Kentucky Power Co., Ky., 605 S.W.2d 46, 50 (1981).” In *The Harbor Condominium Association v. Fourth Ave. Corp.*, Case No. 2000-00379 (August 14, 2001), the Commission further explained the burden: “In order to meet its burden of proof, The Harbor’s contention that Fourth Avenue is unfairly and incorrectly applying the provisions of its tariff must be proven by substantial evidence.” In these cases the Commission found that the complainant did not carry its burden and dismissed the complaint. The Attorney General’s complaint and supporting documents do not provide the Commission with either a valid basis to further investigate Atmos’ rates, or “substantial evidence.” If there is to be a further investigation, the burden clearly is on the Attorney General to provide credible evidence to support his allegations. His attempt to shift the burden to Atmos to prove the reasonableness of its rates is contrary to law and the Commission’s procedures. The Attorney General is attempting to require Atmos to prove its innocence, yet the burden is on the Attorney General to prove that the rates are unreasonable. He has failed to do so and has failed to provide the Commission with sufficient information to meet the threshold test of probable violation of its most recent rate case.

In addition to these inadequacies, the schedules provided by Mr. Henkes are factually incorrect and provide inaccurate information about Atmos’ earnings. Attached are schedules showing corrected calculations and earnings, which refute the conclusion of Mr. Henkes. Schedule 1, which corresponds to Schedule RJH-1 attached to Mr. Henkes testimony, adds rates of return on

equity for Atmos for periods ending June 30, 2004 and September 30, 2004 and corrects the RJH-1 rate of return on equity for the period ending December 31, 2003. Mr. Henkes notes that the Quarterly ROE reports were received from the PSC in response to the AG's Open Records Request dated 10/25/2004. The PSC noted in its response to the AG that the report is prepared for informational purposes only and does not reflect any ratemaking adjustments.

Subsequent to that time, but prior to the AG's filing of the complaint, Atmos had reports on file with the KPSC through September 2004. Schedule RJH-1 failed to show any rates of return more current than March 31, 2004. It is noteworthy that the updated reports show the rate of return on equity declining to 11.25% by September 2004. In addition, Schedule RJH-1 shows an incorrect rate of return of 17.56% for the twelve months ended December 31, 2003. A different method was utilized to calculate the rate of return for that period than was used for the other periods included in Schedule RJH-1. The company has attached the conventional computation of ROE from the monthly financial filings, which produces a rate of return of 14.36% for the twelve months ended December 31, 2003 (Schedule 1-A) and the 11.25% ROE for the twelve months ended September 30, 2004 (Schedule 1-B).

It is also important to note that all of the rates of return for Atmos on this schedule include significant income from unregulated activities. For example, the twelve months ended September 2004 had a net income of \$11,364,504 which included other income from merchandising, interest income and other non-

operating income of \$1,039,974. Including this other income overstates the rate of return for Kentucky utility operations.

Schedule 2, which corresponds to Schedule RJH-2 attached to Mr. Henkes testimony, substitutes the correct capitalization amounts and debt cost rates in the calculation of rates of return on equity from Schedule RJH-2. Schedule RJH-2 rate base and capitalization amounts and debt cost rates were calculated from data included on "Kentucky only" annual reports to the KPSC which do not include investment in assets shared with other states such as the customer information system and the customer service center. These assets are essential to provide service to customers in Kentucky and as a result of their exclusion, Schedule RJH-2 overstates rates of return on equity. Atmos' monthly reports to the KPSC contain capitalization amounts that include an allocated portion of the Company's investment in these shared assets as well as Atmos' actual debt cost rates. Additionally, one of the years included in Schedule RJH-1 was previously addressed in discovery in Case No. 2003-00305. Using the correct data inputs from monthly reports and the information from Case No. 2003-00305, the correct achieved rates of return that should be included on Schedule 2 are 11.45% for 2002, 12.22% for 2003 and 10.69% for 2004.

In a similar situation, the Commission dismissed a complaint by the Kentucky Industrial Utility Customers against LG&E in Case No. 9847. There the Commission found that "(1) KIUC included no analysis of LG&E's current cost of capital or LG&E's current earnings to substantiate its request for the Commission to initiate hearings to adjust LG&E's rates. (2) The Commission staff monitors the

earnings of LG&E and other jurisdictional utilities on a monthly basis to determine whether an adjustment to existing rates is needed.”

Similarly, the Commission receives monthly reports from Atmos on earnings, among other information. No investigation has been warranted by that ongoing review. Significantly, Atmos in Case No. 2003-00305 provided the Commission with detailed information about its earnings in a case involving its Margin Loss Recovery mechanism. No action was taken by the Commission to alert Atmos of possible excess earnings based on the financial information that was filed in that case. The information provided in that case covers substantially the same period as the Attorney General’s analysis in this Complaint. The KIUC case, supra, is clear precedent for the dismissal of this Complaint.

Finally, the conclusion of Mr. Henkes is predicated on the faulty rate making assumption that Atmos should have its rates reduced due to over earning of return on equity. He cites no authority for the Commission to set a rate based on ROE to the exclusion of all other factors relevant to the setting of rates.

Given the lack of factual support for the Complaint and the faulty regulatory assumptions on which it is predicated, the Complaint fails to meet the minimum standard for establishing a prima facie case. The Commission has ruled that a prima facie case is one that states sufficient allegations that if uncontradicted by other evidence would entitle the complainant to the relief sought. *In the Matter of: Kanawha Hall v. Equitable Production Company*, Case 2004-00307 (October 27, 2004). In this case, the Attorney General has not provided any factual support for his conclusions. The assumptions made in the

Complaint have been refuted by the exhibits prepared by Atmos. Additionally, the relief sought is inappropriate in that it requires the Commission to violate ratemaking procedures and set a rate based on only one aspect of Atmos' financial operations, namely return on equity.

Having shown that the data supplied by the Attorney General to support his allegations are not factual and that his request for relief is predicated on the violation of several regulatory principles, his Complaint cannot state a prima facie case. Even if one of those factors were valid, the other would negate a prima facie showing of a legitimate complaint. Yet, the Complaint filed is both factually and legally deficient. For these reasons, the Complaint should be dismissed as failing to meet the criteria of 807 KAR 5:001 (12).

In addition to the factual defects in the Complaint, it is deficient for several legal reasons. First, it attempts to set rates on the single issue of return on equity. The Commission has consistently rejected single issue cases. In its most recent discussion of this principle, the Commission in Case Nos. 2004-00459 and 00460 *The Application of Louisville Gas And Electric Company for Approval of New Rate Tariffs Containing a Mechanism for the Pass-Through of MISO Related Revenues and Costs Not Already Included in Existing Rates* made the following statement of regulatory law:

As defined in KRS 278.010(12), the term rate includes:

“any...compensation for service rendered or to be rendered by any utility....” If the proposed MISO cost surcharges are approved, it appears that the rates now paid by every LG&E and KU electric customer will be adjusted by a charge or credit to reflect the surcharge.



Commission regulation 807 KAR 5:001, Section 10, establishes minimum filing requirements for all applications requesting a general adjustment in existing rates. Those filing requirements include a specific advance notice, as well as detailed financial data and exhibits that are necessary to demonstrate that the applicant's existing rates are not, or will not be, fair, just, and reasonable, and need an adjustment. The MISO cost surcharges are proposed to be mandatory, not optional, rates, and they will recur every month on the bill of every electric customer. Consequently, it appears that LG&E and KU are requesting a general adjustment to every rate classification by including the MISO cost surcharge as a supplement to every rate classification. However, the LG&E and KU applications did not include the financial data and exhibits required by 807 KAR 5:001, Section 10, and the advance notices of filing that were provided did not comply with that regulation.

**Simply stated, the pending applications appear to be requests for the Commission to engage in single-issue rate-making by focusing exclusively on one or more closely related items of revenue and expense, to the exclusion of all other items of revenue and expense.** Although the Commission has, in limited instances, previously engaged in single-issue rate-making, those instances were either specifically authorized by statute or the result of a unanimous agreement by all parties with approval by the Commission. While the General Assembly has authorized single-issue rate-making for recovery of the Commission's annual assessment and the costs of its consultants (KRS 278.130), environmental costs (KRS 278.183), and demand side management costs (KRS 278.285), there is no provision of law authorizing a rate case focused exclusively on MISO-related revenues and expenses. Since LG&E and KU are proceeding under KRS 278.030, which requires rates to be "fair, just and reasonable," their applications appear to be deficient by having omitted the information and schedules required by 807 KAR 5:001, Section 10, to justify a change in rates. (emphasis added)

Interestingly, the Attorney General in that same case "strongly agreed" with the Commission's position against pursuing a single issue rate case. His Brief was filed on January 24, 2005, just one week prior to his filing of the Complaint in this case. In one matter he stands for one proposition, and in the other just the opposite. If the Attorney General believes that single issue ratemaking is improper, as he has stated on the

record in the LG&E case, he should not be allowed to argue the opposite position in this case and succeed.

The second principle that the Attorney General seeks to have the Commission violate is the rule against retroactive ratemaking. The Commission engaged in an extensive review of this principle in *Kentucky Industrial Utility Customers, Inc. v. Big Rivers Electric Corporation*, Case No. 95-011, (April 1, 1997). In that case the Commission said:

The rule against retroactive ratemaking is a 'generally accepted principle of public utility law which recognizes the prospective nature of utility ratemaking and prohibits regulatory commissions from rolling back rates which have already been approved and become final.' **It further prohibits regulatory commissions, when setting utility rates, from adjusting for past losses or gains to either the utility, consumers, or particular classes of consumers.** The rule 'rewards the utility's efficiency and protects the consumer from surprise surcharges allocable to the utility's losses in prior years...[and] ensures fairness, stability and certainty by preventing a regulatory agency from reversing prior approved rates.' (emphasis added)

The Attorney General seeks to have the Commission lower Atmos' approved rates for the sole purpose of correcting what he claims is excessive earnings for the years 2001 through 2003. That is exactly what the rule against retroactive ratemaking prohibits. Rates are based on current data to project what the company's revenue requirements will be for the future. The Attorney General has provided unsupported, inaccurate data on past periods to set rates for the future. There is no legal or regulatory justification for such action.

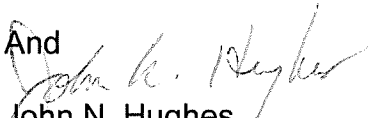
For these reasons, the Complaint should be dismissed.

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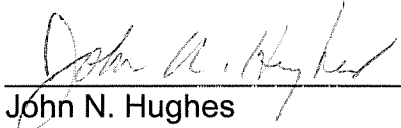
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Certification:

I certify that a copy of this Answer was served on the Attorney General, 1204 Capital Center Dr., Frankfort, KY 40601 by first class mail the 14<sup>th</sup> day of February, 2005.

  
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John N. Hughes

**COMMONWEALTH OF KENTUCKY**

**RETURN ON EQUITY - TWELVE MONTHS ENDED BY QUARTER [1]**  
Corresponds to RJH-1

	AEC Kentucky
Authorized Date	12.50% Sep-90
<u>12-Month Ended</u>	
September 30, 2004	11.25% [2]
June 30, 2004	17.31% [2]
March 31, 2004	17.94%
December 31, 2003	14.36% [3]

- [1] All of these rates of return include significant income from unregulated activities. For example, the twelve months ended September 2004 had a net income of \$11,364,504 which included other income from merchandising, interest income and other nonoperating income of \$1,039,974.
- [2] Schedule RJH-1 stopped at March 2004, Atmos had monthly reports on file at the Commission through September 2004 at the time the AG filed the complaint. See Schedule 1-B for the ROE calculation.
- [3] Schedule RJH-1 shows a rate of return of 17.56% for the twelve months ended December 31, 2003. Using the same method that was used to calculate the other rates of return produces a rate of return of 14.36%. Since this period is already over a year old Atmos did not review any of the even older data on RJH-1. See Schedule 1-A for the ROE calculation.

**COMMONWEALTH OF KENTUCKY**

Calculation of Return on Equity  
For the Twelve Months Ended September 30, 2004

<u>Line Number</u>	<b>Return on Equity:</b>	
1	Kentucky Division Capital Account	\$158,977,684
2	Dallas General Office Capital Allocation	<u>(86,771)</u>
3	Total Capital Account at September 30, 2004	158,890,913
4	Kentucky Division Net Income before Interest	<u>16,498,889</u>
5	Return on Capital Account (Line 4/Line 3)	10.38%
6	Interest Portion of Return on Capital (7.13% x 43%)	<u>3.92%</u>
7	Equity Portion of Return on Capital	6.46%
8	Return on Equity (Line 7/57%)	<u><u>14.36%</u></u>

**NOTE:** The return calculated on this schedule may not be reflective of a normal 12 month period. Adjustments have not been made to normalize items such as weather, expenses or to reflect seasonal changes in capital investment.

**COMMONWEALTH OF KENTUCKY**

Calculation of Return on Equity  
For the Twelve Months Ended September 30, 2004

<u>Line Number</u>	<b>Return on Equity:</b>	
1	Kentucky Division Capital Account	\$180,231,695
2	Dallas General Office Capital Allocation	<u>(2,080,767)</u>
3	Total Capital Account at September 30, 2004	178,150,928
4	Kentucky Division Net Income before Interest	<u>16,668,597</u>
5	Return on Capital Account (Line 4/Line 3)	9.37%
6	Interest Portion of Return on Capital (6.88% x 43%)	<u>2.96%</u>
7	Equity Portion of Return on Capital	6.41%
8	Return on Equity (Line 7/57%)	<u><u>11.25%</u></u>

**NOTE:** The return calculated on this schedule may not be reflective of a normal 12 month period. Adjustments have not been made to normalize items such as weather, expenses or to reflect seasonal changes in capital investment.

**COMMONWEALTH OF KENTUCKY**

RETURN ON EQUITY  
 Corresponds to RJH-2

<u>Line Number</u>		<u>12 Months Ended - \$000</u>		
		<u>9/30/2004</u>	<u>12/31/2003</u>	<u>12/31/2002</u>
1	Adjusted Capitalization	178,151	158,891	151,528 [1]
2	Adjusted Utility Operating Income	15,650	15,371	14,730
3	Achieved Return on Capitalization	8.78%	9.67%	9.72% L2 / L1
4	Weighted Cost of Debt Assuming 50% Debt Ratio	<u>3.440%</u>	<u>3.565%</u>	<u>3.995%</u> [2]
5	Equity Return Portion of Achieved Return ofn Capitalization	5.34%	6.11%	5.73% L3 - L4
6	Achieved Return on Equity Assuming 50% Equity Ratio	<u>10.69%</u>	<u>12.22%</u>	<u>11.45%</u> L5 / 50%

[1] Capitalization for 2002 from PSC DR 1 - Item 2 Case No. 2003-00305. Capitalization for 2003 and 2004 from monthly reports to PSC.

Schedule RJH-2 Rate Base and Capitalization are calculated from data on "Kentucky Only" Annual Reports to the KPSC which do not include investment in assets shared with other states such as the customer information system and the customer service center.

[2] Debt Cost Rate for 2002 from PSC DR 1 - Item 2 Case No. 2003-00305. Debt Cost Rate for 2003 and 2004 from monthly reports to PSC.

RJH-2 debt cost rates differ significantly from the company's actual debt cost rates.