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February 23, 2007

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PUBLIC SERVICE
COMMISSION

Beth O'Donnell
Executive Director
Public Service Commission
211 Sower Blvd.
Frankfort, KY 40601

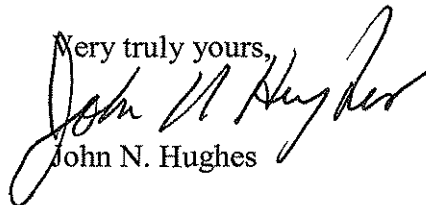
Case No. 2005-00057

Dear Beth:

Please file the testimony of Atmos' witnesses, James C. Cagle and Donald A. Murry, Ph.D., which is submitted pursuant to the Commission's order of February 9, 2007. Copies of this testimony have been delivered to the Attorney General.

If there are any questions about this filing, please contact me.

Very truly yours,



John N. Hughes

Attorney for Atmos Energy
Corporation

Attachments

CC: Attorney General

BEFORE THE PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY

OFFICE OF THE ATTORNEY GENERAL)
COMMONWEALTH OF KENTUCKY)
)Case No. 2005-00057
V.)
)
ATMOS ENERGY CORPORATION)

TESTIMONY OF JAMES C. CAGLE

I. INTRODUCTION

1

2

3 **Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.**

4 A. My name is James C. Cagle. I am the Manager of Rates and Revenue
5 Requirements for Atmos Energy Corporation ("Atmos" or the "Company"). My
6 business address is 5430 LBJ Freeway, Suite 700, Dallas, Texas 75240.

7 **Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND**
8 **PROFESSIONAL EXPERIENCE.**

9 A. I received a Bachelor of Accountancy degree from the University of Oklahoma in
10 1987. I am a Certified Public Accountant licensed in the state of Texas. I have
11 been employed by Atmos since 1989. I was initially employed in Atmos'
12 financial reporting department. For the past thirteen years, except for the period
13 from September 1997 through February 1998 when I was employed by GTE in its
14 costing department, I have worked in Atmos' rates department.

15 **Q. PLEASE DESCRIBE YOUR CURRENT RESPONSIBILITIES AND**
16 **QUALIFICATIONS.**

17 A. As Manager of Rates and Revenue Requirements, I am primarily responsible for
18 rate studies of and assisting in the design and implementation of rates for Atmos'
19 regulated utility operations. I am also responsible for oversight of certain rate

1 related compliance and reporting requirements prescribed by Atmos' various
2 regulatory commissions. For a significant portion of the past thirteen years, I
3 have performed rate studies or portions of rate studies for the design and
4 implementation of rates for a majority of the Atmos' operations.

5 **Q. HAVE YOU PREVIOUSLY PROVIDED TESTIMONY BEFORE THE**
6 **KENTUCKY PUBLIC SERVICE COMMISSION?**

7 A. Yes. I provided testimony in Docket No. 2006-00464. I have also provided
8 testimony before several other state commissions. Exhibit JCC-1 attached hereto
9 lists the various states and dockets in which I have testified.

10 **Q. PLEASE BRIEFLY DESCRIBE THE PURPOSE OF YOUR TESTIMONY.**

11 A. The purpose of my testimony is to address the testimony of Mr. Henkes in this
12 case.

13 **Q. WHAT IS YOUR UNDERSTANDING OF THE CURRENT STATUS OF**
14 **THIS CASE?**

15 A. In its Order of February 2, 2006, the Commission put the Attorney General on
16 notice that following discovery he must produce substantial evidence on the
17 appropriate ROE level for Atmos. The Commission specifically stated that, at a
18 minimum, the Attorney General's expert testimony must contain: a detailed ROE
19 analysis, that specifically identifies the currently appropriate ROE for Atmos'
20 Kentucky operation; a detailed analysis of the current economic conditions
21 affecting the company's operations, a Rate Base, Capitalization, Capital Structure
22 and Statement of Operations for Atmos Kentucky as of September 30, 2005 and a
23 determination of the appropriate Revenue Requirement for Atmos' Kentucky
24 operations.

25 **Q. IN REVIEWING THE TESTIMONY PRESENTED BY THE ATTORNEY**
26 **GENERAL, HAS THIS INFORMATION BEEN PROVIDED?**

27 A. No. Although Mr. Henkes' filed testimony contains numerous calculations and
28 proposed findings, they are all based, by his own admission, on raw, unadjusted
29 test year rate base, capitalization, capital structure, and operating income. This is
30 inconsistent with fundamental rate making principals and clearly falls short of the

1 Commission's requirement that "...the Attorney General must clearly establish
2 that Atmos' current rates are producing an ROE that is excessive under present
3 economic conditions." (Commission Order of February 2, 2006, p. 4).

4 **Q. DO YOU HAVE AN OPINION AS TO WHY MR. HENKES DID NOT**
5 **MAKE NORMAL RATEMAKING PRO FORMA ADJUSTMENTS AS**
6 **PART OF HIS ANALYSIS?**

7 **A.** On page 5 of his supplemental testimony, Mr. Henkes indicates that although he
8 had identified a number of pro forma adjustments for which he had available data
9 there were a "significant number" of other potential adjustments that he did not
10 have necessary data and could not make. Mr. Henkes apparently decided that if
11 he could not make all the adjustments he felt were appropriate, he would make
12 none at all.

13 **Q. IN YOUR OPINION, COULD MR. HENKES HAVE MADE THE**
14 **NORMAL AND CUSTOMARY RATE MAKING PRO FORMA**
15 **ADJUSTMENTS IN THIS PROCEEDING?**

16 **A.** Absolutely. The Attorney General was provided ample opportunity through three
17 rounds of data requests to obtain from the Company all financial information
18 necessary to make those adjustments. Extensive financial information was
19 provided by the Company. For some of the adjustments that should have been
20 made, Mr. Henkes failed to use information that had been provided by Atmos and
21 in other instances, he failed to request information he apparently felt he needed.

22 **Q. DOES MR. HENKES' TESTIMONY CONTAIN AN ANALYSIS OF**
23 **"ATMOS' ROE UNDER CURRENT ECONOMIC CONDITIONS" AS**
24 **REQUIRED BY THE COMMISSION'S ORDER OF FEBRUARY 2, 2006?**

25 **A.** No. The failure to provide an analysis of Atmos' earnings using current economic
26 conditions not only violates the Commission's order, but it makes any conclusions
27 about those earnings incomplete.

28 **Q. IN ITS REQUEST FOR INFORMATION #2 TO THE ATTORNEY**
29 **GENERAL, COMMISSION STAFF ASKED MR. HENKES ABOUT**
30 **SEVERAL PRO FORMA ADJUSTMENTS HE HAD FAILED TO MAKE.**

1 SPECIFICALLY, WHETHER HE AGREED THAT THEY WERE
2 NORMAL RATEMAKING ADJUSTMENTS AND THAT SUFFICIENT
3 INFORMATION HAD BEEN PROVIDED BY ATMOS TO MAKE SUCH
4 ADJUSTMENTS. AS TO EACH OF THE PRO FORMA ADJUSTMENTS
5 MENTIONED BY THE STAFF, DO YOU BELIEVE THERE WAS
6 SUFFICIENT INFORMATION IN THE RECORD TO ENABLE THE
7 ADJUSTMENTS TO BE MADE.

8 A. Yes.

9 Q. HAD MR. HENKES PERFORMED THE ADJUSTMENTS REFERRED
10 TO BY THE STAFF, WOULD HE HAVE MET THE REQUIREMENTS
11 OF THIS CASE?

12 A. Certainly making the adjustments noted by Commission Staff would have made a
13 good start. However, only Mr. Henkes knows what other types of adjustments he
14 may have had in mind. As these adjustments were not calculated, I cannot
15 comment on whether these adjustments would have resulted in a more accurate
16 reflection of the company's financial operations going forward.

17 Q. HAS ATMOS PROVIDED THE ATTORNEY GENERAL WITH ALL
18 INFORMATION THAT WAS REQUESTED?

19 A. Yes. To my knowledge, the Company has provided responses to all of his data
20 requests to the extent that the Commission determined those requests to be
21 appropriate to this proceeding.

22 Q. CAN YOU PROVIDE AN EXAMPLE OF MR. HENKES CLAIMING HE
23 DID NOT HAVE INFORMATION NECESSARY TO PERFORM A
24 NORMAL RATEMAKING ADJUSTMENT WHEN, IN FACT, THE
25 INFORMATION WAS AVAILABLE.

26 A. Yes. On page 5, lines 14 through 18 of his supplemental testimony, Mr. Henkes
27 states he was unable to make a weather normalization adjustment without
28 "complex modeling information that is only available and controlled by the
29 Company". The information to make an adjustment to revenues for the effects of
30 weather requires certain billing information (i.e. customers and volumes by

1 month, by location) and normal and actual heating degree day information
2 available from the National Oceanic and Atmospheric Administration.

3 **Q. WAS THAT INFORMATION REQUESTED FROM THE COMPANY?**

4 A. Not to my knowledge.

5 **Q. ON PAGE 5 OF MR. HENKES' SUPPLEMENTAL TESTIMONY, HE**
6 **SAYS THAT HE IS PRESENTING HIS EARNINGS REVIEW ON**
7 **UNADJUSTED TEST YEAR RATE BASE, CAPITALIZATION, CAPITAL**
8 **STRUCTURE AND OPERATING INCOME DATA. ON PAGE 7 OF**
9 **THAT TESTIMONY HE CONCLUDES THAT "KENTUCKY RATES**
10 **SHOULD BE REDUCED APPROXIMATELY \$5.3 MILLION TO**
11 **ACHIEVE JUST AND REASONABLE UTILITY RATES FOR ATMOS'**
12 **KENTUCKY CONSUMERS." DOES HIS DATA SUPPORT HIS**
13 **CONCLUSION?**

14 A. No. The concept of fair, just and reasonable rates is based on certain ratemaking
15 principles. Included among those principles is the use of adjusted test year
16 financial data to reflect the ongoing costs of the Company's actual operations.
17 Mr. Henkes' testimony does not conform to those ratemaking principles and as a
18 result his conclusion as to the level of revenue needed for Atmos' operation is
19 inconsistent with prior Commission orders and with generally accepted
20 ratemaking principles.

21 **Q. IN RESPONSE TO QUESTIONS 1(E) AND 2 OF THE COMMISSION'S**
22 **REQUEST FOR INFORMATION TO THE ATTORNEY GENERAL, MR.**
23 **HENKES ADMITS THAT HE HAD SUFFICIENT INFORMATION TO**
24 **MAKE CERTAIN PRO FORMA ADJUSTMENTS, BUT CHOOSES NOT**
25 **TO DO SO. IS IT APPROPRIATE FOR RATEMAKING PURPOSES TO**
26 **SELECTIVELY USE PRO FORMA ADJUSTMENTS WHEN THE**
27 **INFORMATION TO MAKE SUCH ADJUSTMENTS IS AVAILABLE?**

28 A. No. If information is available and that information indicates an adjustment is
29 appropriate, the adjustment should be made.

1 **Q. DOES ATMOS AGREE WITH MR. HENKES' CONCLUSION AS TO**
2 **THE LEVEL OF APPROPRIATE EARNINGS?**

3 A. No. The Company is confident that the information provided in response to the
4 data requests fully refutes the Attorney General's allegations about our earnings.
5 However, because the Attorney General has chosen not to make appropriate
6 adjustments to the test year information provided by the Company, it is difficult to
7 respond specifically to his allegations.

8 **Q. IN GENERAL TERMS, WHAT WOULD BE THE EFFECT OF SETTING**
9 **RATES ON UNADJUSTED TEST YEAR DATA?**

10 A. The purpose of adjusting test year financial data is to make the data used for
11 ratemaking consistent with the Company's most current operations. The
12 consideration of known and measurable changes is a key principle in determining
13 appropriate cost levels in setting rates going forward. One example of an
14 adjustment Mr. Henkes rejected was an adjustment for known and measurable
15 levels of labor expense. Without adjusting for this known and measurable change,
16 there is an immediate mismatch in the level of ongoing costs and ongoing
17 revenues if a change in rates results.

18 **Q. IF THAT ONE ADJUSTMENT HAS A SIGNIFICANT AFFECT ON THE**
19 **CALCULATION OF THE REVENUE REQUIREMENT, WHAT WOULD**
20 **BE THE CUMULATIVE EFFECT OF USING UNADJUSTED DATA FOR**
21 **ALL ACCOUNTS?**

22 A. The cumulative effect of using unadjusted data would be to significantly distort
23 the company's financial operations and the rates derived from those distorted
24 calculations would be just as distorted. The purpose of setting rates is to assure
25 that the company and the ratepayers are treated fairly. Setting rates on the
26 information provided by the Attorney General would be a departure from
27 traditional ratemaking procedures and would not provide a fair review of its
28 operations or reasonable rates to be paid by the customers. In fact, cumulatively
29 the information is meaningless for ratemaking purposes.

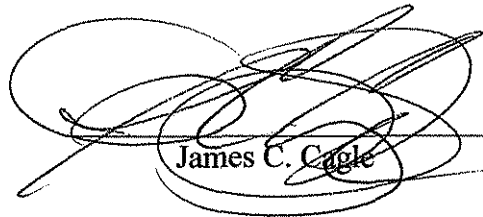
30 **Q. DOES THAT CONCLUDE YOUR TESTIMONY?**

1 A. Yes.

AFFIDAVIT

State of Texas
County of Dallas

Affiant, James C. Cagle, after being first sworn, deposes and states that the foregoing prepared testimony is true and correct to the best of his knowledge and belief except as to those matters that are based on information provided to him and as to those he believes to be true and correct.

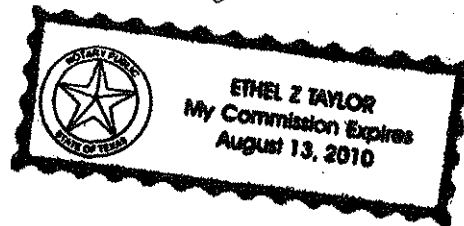

James C. Cagle

This instrument was produced, signed and acknowledged by James C. Cagle to be his act and deed the 20th day of February, 2007.

Notary Public



My Commission expires: August 13, 2010



**BEFORE THE PUBLIC SERVICE COMMISSION
COMMONWEALTH OF KENTUCKY**

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

Case No. 2005-00057

TESTIMONY OF DONALD A. MURRY

I. INTRODUCTION

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Q. PLEASE STATE YOUR NAME.

A. Donald A. Murry.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT POSITION?

A. I am a Vice President and economist with C. H. Guernsey & Company. I work out of the Oklahoma City office at 5555 North Grand Boulevard, 73112, and the Tallahassee office. I am also a Professor Emeritus of Economics on the faculty of the University of Oklahoma.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I have a B. S. in Business Administration, and a M.A. and a Ph.D. in Economics from the University of Missouri - Columbia.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL BACKGROUND.

A. From 1964 to 1974, I was an Assistant and Associate Professor and Director of Research on the faculty of the University of Missouri - St. Louis. For the period

1 1974-98, I was a Professor of Economics at the University of Oklahoma, and
2 since 1998 I have been Professor Emeritus at the University of Oklahoma. Until
3 1978, I also served as Director of the University of Oklahoma's Center for
4 Economic and Management Research. In each of these positions, I directed and
5 performed academic and applied research projects related to energy and
6 regulatory policy. During this time, I also served on several state and national
7 committees associated with energy policy and regulatory matters, published, and
8 presented a number of papers in the field of regulatory economics in the energy
9 industries.

10 **Q. WHAT IS YOUR EXPERIENCE IN REGULATORY MATTERS?**

11 A. I have consulted for private and public utilities, state and federal agencies, and
12 other industrial clients regarding energy economics and finance and other
13 regulatory matters in the United States, Canada, and other countries. In 1971-72, I
14 served as Chief of the Economic Studies Division, Office of Economics of the
15 Federal Power Commission. From 1978 to early 1981, I was Vice President and
16 Corporate Economist for Stone & Webster Management Consultants, Inc. I am
17 now a Vice President with C. H. Guernsey & Company. In all of these positions I
18 have directed and performed a wide variety of applied research projects and
19 conducted other projects related to regulatory matters. I have assisted both private
20 and public companies and government officials in areas related to the regulatory,
21 financial, and competitive issues associated with the restructuring of the utility
22 industry in the United States and other countries.

1 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE OR BEEN AN EXPERT**
2 **WITNESS IN PROCEEDINGS BEFORE REGULATORY BODIES?**

3 A. Yes, I have appeared before the U.S. District Court-Western District of Louisiana,
4 U.S. District Court-Western District of Oklahoma, District Court-Fourth Judicial
5 District of Texas, U.S. Senate Select Committee on Small Business, Federal
6 Power Commission, Federal Energy Regulatory Commission, Interstate
7 Commerce Commission, Alabama Public Service Commission, Alaska Public
8 Utilities Commission, Arkansas Public Service Commission, Colorado Public
9 Utilities Commission, Florida Public Service Commission, Georgia Public
10 Service Commission, Illinois Commerce Commission, Iowa Commerce
11 Commission, Kansas Corporation Commission, Kentucky Public Service
12 Commission, Louisiana Public Service Commission, Maryland Public Service
13 Commission, Mississippi Public Service Commission, Missouri Public Service
14 Commission, Nebraska Public Service Commission, New Mexico Public Service
15 Commission, New York Public Service Commission, Power Authority of the
16 State of New York, Nevada Public Service Commission, North Carolina Utilities
17 Commission, Oklahoma Corporation Commission, South Carolina Public Service
18 Commission, Tennessee Public Service Commission, Tennessee Regulatory
19 Authority, The Public Utility Commission of Texas, the Railroad Commission of
20 Texas, the State Corporation Commission of Virginia, and the Public Service
21 Commission of Wyoming.

22 **Q. WHAT IS THE NATURE OF YOUR TESTIMONY?**

1 A. I have been retained by Atmos Energy Corporation (“Atmos”) to review the
2 Direct Testimony of J. Randall Woolridge and to form an opinion regarding the
3 basis and adequacy of his recommended return for Atmos in this proceeding.

4 **Q. HAVE YOU REVIEWED DR. WOOLRIDGE’S TESTIMONY AND**
5 **FORMED AN OPINION ABOUT HIS TESTIMONY?**

6 A. Yes, I have. Based on my review of the testimony by Dr. Woolridge, the data he
7 provided in the exhibits that accompanied his testimony, and his data responses, I
8 have formed an opinion regarding his recommendations.

9 **II. SUMMARY OF FINDINGS**

10 **Q. CAN YOU SUMMMARIZE YOUR FINDINGS AND THE OPINIONS**
11 **THAT YOU HAVE FORMED FROM YOUR REVIEW OF HIS**
12 **TESTIMONY?**

13 A. Yes, I can summarize my findings in several general areas based on my review of
14 his testimony. Also, I have provided an exhibit with seven schedules that
15 illustrate some of my findings. First, he adopted an inappropriate capital structure
16 for determining the total cost of permanent capital of Atmos. He incorrectly
17 included short-term debt in the permanent capital structure of Atmos, when the
18 evidence available to him at the time that he prepared his testimony did not
19 support this. Contrary to the implications of Dr. Woolridge’s recommended
20 capital structure, Atmos does not use short-term debt as a source of capital to
21 support its permanent assets. That is, when I reviewed the short-term debt
22 information in the work papers that Atmos provided in this case, they show

1 clearly that short-term debt is not a component of the company's permanent
2 capital structure. Second, Dr. Woolridge apparently disregarded the basic market
3 information available to him when determining a return on common stock to
4 recommend in this proceeding. In fact, he ignored the basic market information
5 that he presented in his own exhibits. As a consequence, he recommended a return
6 on common stock equity that is way below the current market returns and
7 common regulatory policies. Third, when I reviewed the methodology that Dr.
8 Woolridge described in his testimony, the reasons for his low recommended
9 return on common stock equity were apparent: his testimony contains several
10 obvious, serious methodological errors. I concluded that these problematic
11 methods produced erroneous conclusions and contributed to his flawed
12 recommendation. Finally, in his analysis Dr. Woolridge used an out-dated cost of
13 debt for Atmos, which was effective as of September 30, 2005, although the
14 Attorney General had updated information available; Atmos provided cost of debt
15 as of March 31, 2006, in discovery responses.¹

16 **III. SHORT-TERM DEBT**

17 **Q. CAN YOU EXPLAIN YOUR COMMENTS REGARDING DR.**
18 **WOOLRIDGE'S INAPPROPRIATE INCLUSION OF SHORT-TERM**
19 **DEBT IN THE CAPITAL STRUCTURE OF ATMOS?**

20 **A.** Dr. Woolridge, in (JRW-1), specified a capital structure for Atmos that included
21 3.68 percent short-term debt. Not only did Dr. Woolridge fail to support the

¹ In Response to Question No. 7 of the Attorney General's Second Set of Data Requests, the Company disclosed that at March 31, 2006, its long-term debt cost was 5.96%, and its short-term debt cost was 6.12%.

1 inclusion of short-term debt in Atmos' capital structure, but he also ignored the
2 evidence that Atmos does not use short-term debt to support its long-term assets.
3 The permanent capital that supports the rate base assets, which provide utility
4 service to utility customers, is the appropriate capital for ratemaking.

5 **Q. WHY DID YOU SAY THAT DR. WOOLRIDGE FAILED TO SUPPORT**
6 **THE INCLUSION OF SHORT-TERM DEBT IN ATMOS' CAPITAL**
7 **STRUCTURE?**

8 A. The components of a capital structure in a ratemaking proceeding are the sources
9 of capital which the utility uses to support its long-term assets that provide utility
10 service, or applying this principal to this instant case, components of capital that
11 support the assets that form Atmos' rate base in Kentucky. Dr. Woolridge did not
12 provide any evidence that Atmos used short-term debt as a component of its
13 permanent capital structure.

14 **Q. WHY DID YOU STATE THAT DR. WOOLRIDGE IGNORED EVIDENCE**
15 **THAT ATMOS DID NOT USE SHORT-TERM DEBT TO SUPPORT ITS**
16 **LONG-TERM ASSETS IN KENTUCKY?**

17 A. In response to AG 2-7e, Atmos reported the monthly average daily balance of
18 short-term debt for the period from November 2004 to March 2006. A review of
19 these data shows that short-term debt cannot be a source of permanent capital
20 which supports the companies' acquisition of long-term assets providing utility
21 service in Kentucky. First, the levels of short-term debt fluctuate much more
22 dramatically than the level of rate base assets could possibly fluctuate. This
23 implies that the company uses short-term debt to meet the fluctuating business

1 expenses such as the acquisition of natural gas. Second, during February-April
2 2005 period, the level of short-term debt was zero or nearly so; obviously, if
3 short-term debt disappears entirely in sequential months, it cannot support long-
4 lived assets that make up the rate base. Finally, the short-term debt ballooned in
5 the fall of 2005, which was during the period that Atmos financed the acquisition
6 of the TXU properties in Texas. Historically, Atmos has used short-term debt to
7 temporarily fund the acquisition of gas distribution assets; that is, the company
8 uses short-term debt as bridge financing until it secures more permanent financing
9 in the form of long-term debt and common stock. I have illustrated the short-term
10 debt data provided in AG 2-7e in Schedule DAM-1. The graph in Schedule DAM-
11 2 illustrates the wide dispersion of the levels of short-term debt of Atmos during
12 this period.

13 IV. RETURN ON COMMON EQUITY

14 **Q. YOU DESCRIBED DR. WOOLRIDGE'S RECOMMENDED ALLOWED**
15 **RETURN AS VERY LOW. WHAT IS THE REASON FOR THAT**
16 **STATEMENT?**

17 **A.** Dr. Woolridge recommended an allowed return on common equity of 9.0 percent.
18 He stated, at page 1, lines 12-20 of his Direct Testimony, as follows:

19 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS
20 PROCEEDING?

21 A. I have been asked by the Kentucky Office of Attorney General to
22 provide an opinion as to the overall fair rate of return or cost of capital
23 for the Kentucky Division of Atmos Energy Corp.

24 Q. PLEASE REVIEW YOUR COST OF CAPITAL RETURN
25 FINDINGS.

1 A. I have independently arrived at a cost of capital for Atmos-KY. I have
2 established an equity cost rate of 9.00% for Atmos-KY by applying the
3 Discounted Cash Flow Model (“DCF”) and the Capital Asset Pricing
4 Model (“CAPM”) to a group of publicly held natural gas distribution
5 companies.
6

7 I believe that Dr. Woolridge recommended an unreasonably low return on
8 common stock, at least partially, because he applied an unorthodox standard for
9 the level of common stock return for Atmos. He seemed also to be deceived by
10 the results of his conceptually flawed DCF and CAPM analyses.

11 **Q. WHAT DO YOU MEAN THAT DR. WOOLRIDGE DID NOT USE AN**
12 **ORTHODOX STANDARD FOR THE LEVEL OF COMMON STOCK**
13 **RETURN FOR ATMOS?**

14 A. On page 50, line 18 through page 51, line 3 of his Direct Testimony, Dr.
15 Woolridge refers to the market-to-book ratios in his Exhibit (JRW-3), and he
16 states on lines 2-5,

17 These results clearly indicate that, on average, *these companies are*
18 *earning returns on equity above their equity cost rates.* As such, this
19 observation provides evidence that my recommended equity cost rate of
20 9.00% is reasonable and fully consistent with the financial performance
21 and market valuation of the group of gas distribution companies.
22 [*Emphasis added*]
23

24 Incredibly, Dr. Woolridge concluded that the companies that he used as a
25 representative sample to determine returns in the local gas distribution industry
26 averaged earned returns that exceeded their equity cost rates. He included Atmos
27 in his group of 12 local distribution companies, so, by definition, if the group is
28 “earning returns on equity above their equity cost rate,” he also could conclude
29 that “...my recommended equity cost rate of 9.00% is reasonable and fully

1 consistent with the financial performance and market valuation of the group of
2 gas distribution companies.” (Woolridge Direct, page 50, lines 3-5). Furthermore,
3 Dr. Woolridge continued the silliness of this Alice-In-Wonderland logic and did
4 not bother to investigate whether Atmos, which had the lowest market-to-book
5 ratio of all of the companies that he studied, might NOT be “earning returns on
6 equity above their equity cost rate.” As Dr. Woolridge’s Exhibit (JRW-3) shows,
7 the market-to-book ratios of all 12 of the companies that he analyzed averaged
8 1.67 times, but Atmos’ ratio was 1.25 times. .

9 **Q. IN YOUR OPINION, WHAT STANDARD WOULD HAVE BEEN MORE**
10 **APPROPRIATE FOR DR. WOOLRIDGE TO USE IN HIS ANALYSIS OF**
11 **THE RETURN OF ATMOS?**

12 A. I think that Dr. Woolridge could have applied a common standard for a fair rate of
13 return, such as a return that provides earnings to investors similar to returns on
14 alternative investments of equivalent risk. I believe trying to determine a return
15 for investments of equivalent risks would also approximate the standard set forth
16 in *Federal Power Commission vs. Hope Natural Gas Company*, 320 U.S. 591
17 (1944), at least as I understand the principles set forth in this decision. At least, if
18 Dr. Woolridge had used a standard of returns of equivalent risks when
19 investigating Atmos’ return, he could have avoided some of the more obvious
20 problems with his analysis.

21 **Q. HOW COULD DR. WOOLRIDGE HAVE AVOIDED SOME OF THE**
22 **PROBLEMS IN HIS ANALYSIS IF HE HAD USED THE STANDARD OF**
23 **A RETURN FOR INVESTMENTS OF EQUIVALENT RISKS?**

1 A. If Dr. Woolridge had used the standard of a “return on investment of equivalent
2 risk,” he would have had to address the question: “What would Atmos’ return on
3 equity need to be to produce a market-to-book ratio of 1.67 times?” If he had done
4 that, assuming a constant price-earnings ratio, he would have concluded that
5 Atmos should earn 11.76 percent on common equity. That is, using the numbers
6 from Dr. Woolridge’s JRW-3, Atmos’ stated common equity earnings of 8.8
7 percent would need to grow to 11.76 percent, i.e. $(11.76\%/8.8\% = 1.67/1.25)$, to
8 achieve the average market-to-book ratio of Dr. Woolridge’s group of companies.
9 Also, he probably would have noted that Atmos’ current return on common stock,
10 which he reported in his Exhibit (JRW-3), was just 8.8 percent. Finally, he
11 probably would have noted that this was much lower than the average returns on
12 common stock for the group he studied. He reported in his exhibit that the average
13 return for the group he studied was 10.6 percent. Only by believing the gas
14 companies in his comparable group earned “returns greater than their cost of
15 equity” could he conclude that Atmos’ return on common equity was not
16 inordinately low. I have illustrated the common equity return information
17 reported in Dr. Woolridge’s Exhibit (JRW-3) in Schedule DAM-3.

18 **Q. DID DR. WOOLRIDGE REVIEW OTHER INFORMATION THAT**
19 **SHOULD HAVE REVEALED THAT HIS RECOMMENDATION OF A**
20 **RETURN OF 9.0 PERCENT ON COMMON EQUITY WAS TOO LOW?**

21 A. Dr. Woolridge reported several measures of risk in his Exhibit (JRW-3). Each one
22 of these measures showed that, when compared to the group of companies that he
23 studied, Atmos’ common equity was a relatively high risk investment. For

1 example, the data reported by Dr. Woolridge in Exhibit (JRW-3) showed that the
2 median S&P bond rating for the group that he studied was "A," but Atmos' bond
3 rating was "BBB". This shows clearly that S&P bond analysts have determined
4 that Atmos' securities are relatively more risky than the group of distribution
5 companies. Likewise, the average Pre-Tax Interest Coverage for the group of
6 companies that Dr. Woolridge studied was 3.4 times, but the Pre-Tax Interest
7 Coverage of Atmos was just 2.6 times. The interest coverage statistic is an
8 important measure of risk because it is a measure of the number of times that a
9 company's funds from operations cover its fixed-cost, interest obligation. In
10 addition, Dr. Woolridge reported that the average Common Equity Ratios of all of
11 the companies that he studied was 48 percent. His reported Common Equity
12 Ratio of Atmos was just 41 percent. Since debt instruments have claims to any
13 returns that are precedent to the claims of common equity, the Common Equity
14 Ratio is a direct measure of financial risk. I have shown all of Dr. Woolridge's
15 comparisons, as reported in his Exhibit (JRW-3), in my Schedule DAM-4. If Dr.
16 Woolridge had applied a standard of determining a return on common equity for
17 Atmos, which was equal to returns on investments of equivalent risk, he probably
18 would have noticed that the risk information he studied showed Atmos to be a
19 relatively high risk investment.

20 **Q. ARE YOU AWARE OF OTHER INFORMATION THAT SHOULD HAVE**
21 **BEEN AVAILABLE TO DR. WOOLRIDGE THAT WOULD HAVE**
22 **DEMONSTRATED THAT HIS RECOMMENDED 9.0 PERCENT**
23 **RETURN ON COMMON EQUITY WAS EXCEPTIONALLY LOW?**

1 A. Dr. Woolridge might have reviewed the allowed returns on common equity for
2 gas distribution companies awarded in the months prior to his testimony.
3 Although reviewing allowed returns in other jurisdictions may not be a governing
4 factor of a reasonable return for Atmos in Kentucky, Dr. Woolridge should have
5 considered looking at them. If he had reviewed other returns, he would have seen
6 that he was recommending a return that, according to Regulatory Research
7 Associates, was lower than all allowed returns for gas distribution utilities in the
8 U.S. in 2006. As Schedule DAM-5 shows, Regulatory Research Associates
9 reported in July, 2006, no return on common stock was as low as 9.0 percent. This
10 could have been a signal to Dr. Woolridge that his recommendation was an
11 outlier. Professional prudence would have demanded, at least, that he investigate
12 and explain why his recommendation was extraordinarily low. In fact, the only
13 return that was close to his recommended allowed return was Southwest Gas'
14 allowed return in Arizona. Upon closer scrutiny though, his recommendation is
15 more out of line than it first appears because Arizona is a fair-value-rate-base
16 jurisdiction. Consequently, his recommended allowed return of 9.0 percent on
17 book value may be even further out of line than it first appears.

18 **V. DR. WOOLRIDGE'S CAPM ANALYSIS**

19 **Q. YOU INDICATED A METHODOLOGICAL PROBLEM WITH DR.**
20 **WOOLRIDGE'S CAPM ANALYSIS. WHAT PROBLEMS WERE YOU**
21 **REFERRING TO WHEN YOU MADE THAT STATEMENT?**

1 A. Dr. Woolridge's CAPM analysis has multiple errors, but with one example, I can
2 demonstrate how his selection of unrealistic data for his CAPM analysis led to
3 erroneous conclusions.

4 **Q. WHAT WAS THE UNREALISTIC DATA SELECTION THAT YOU**
5 **NOTED IN DR. WOOLRIDGE'S CAPM ANALYSIS?**

6 A. Dr. Woolridge's selection of data used to estimate "the expected return on the
7 overall stock market," as described on page 28, lines 20-21 and presented in
8 Exhibit (JRW-8), page 5 of 5 of his Direct Testimony, biased his CAPM
9 calculation to produce a low estimate. In Exhibit (JRW-8), Dr. Woolridge defined
10 a key term in the CAPM as follows: "E(R_m) represents the expected return on the
11 overall stock market." He did not even correctly specify this CAPM term;
12 however, the error that shows the bias in his CAPM is his selection of data.

13 **Q. HOW DID DR. WOOLRIDGE'S DATA SELECTION AFFECT HIS CAPM**
14 **ESTIMATE OF THE COST OF CAPITAL?**

15 A. Dr. Woolridge used an arbitrary "Building Blocks Methodology" to estimate an
16 "Ex Ante Expected Market Return" of 8.10 percent; a key component of this
17 market return was an estimate of investors' "Real EPS Earnings" expectations.
18 He developed these by using S&P 500 data for the years from 1960 through 2005.
19 He illustrated this calculation in (JRW-8), page 5 of 5, which showed how he
20 estimated a very low real EPS growth of 2.71 percent.

21 **Q. WHY WAS DR. WOOLRIDGE'S ESTIMATED EPS GROWTH OF 2.71**
22 **PERCENT GROWTH LOW?**

1 A. Dr. Woolridge's 2.71 "Real Earnings" growth rate is low because of his arbitrary
2 selection of the time period over which he calculated it. My Schedule DAM-7
3 reveals the arbitrary nature of the 1960-2005 time period which he selected for
4 analysis. As my schedule shows, the trend in the growth rate was flat until
5 approximately 1991, and then it turned sharply upward. It followed this steeper
6 trend for the past, approximately 15 years. Of course, Dr. Woolridge's data
7 selection is methodologically flawed, and misleading, because investors are more
8 likely to base their future expectations on recent trends than on market
9 performance over 40 years ago. Using more recent data, with a higher resulting
10 growth rate, would have had a significant effect upon Dr. Woolridge's
11 calculations.

12 **Q. DID YOU CALCULATE WHAT EFFECT THIS ONE CHANGE,**
13 **NAMELY SELECTING THE S&P EARNINGS PER SHARE DATA**
14 **SINCE 1991 RATHER THAN SINCE 1960, WOULD HAVE HAD ON DR.**
15 **WOOLRIDGE'S ESTIMATED CAPM COST OF EQUITY?**

16 A. Yes, I did. If Dr. Woolridge had used the period since 1991 to calculate his S&P
17 500 Growth in Earnings, the result would have been 6.76 percent. Consequently,
18 in the table on page 44, line 8 of his Direct Testimony, he would have estimated
19 an "Expected Market Return" of 11.91 percent, rather than 8.10 percent, and on
20 page 48, line 20, he would have calculated an "Equity Cost Rate" of 12.90 percent
21 rather than the 8.60 percent that he reported.

22 **VI. DR. WOOLRIDGE'S DCF ANALYSIS**

1 **Q. YOU MENTIONED SOME CONCERN WITH DR. WOOLRIDGE'S DCF**
2 **ANALYSIS. CAN YOU EXPLAIN THOSE CONCERNS?**

3 A. Dr. Woolridge's DCF calculation also has numerous difficulties, but I believe that
4 the most obvious problem is his use of a seriously flawed DCF methodology. The
5 "Internal Growth Rate" DCF, which he applied, is logically circular, and
6 inevitably produces low, biased results. The fundamental defect with this method
7 is that analysts must assume one return on equity in order to estimate another. As
8 I show in Schedule DAM-8, which I compiled from data in Exhibit (JRW-7),
9 page 4 of 5, Dr. Woolridge assumed an average return on equity for his proxy
10 group of 11.5 percent. He used this 11.5 percent return to estimate, as he
11 demonstrated on page 27, line 10 of his Direct Testimony, an "Equity Cost Rate"
12 of 8.74 percent. This DCF method is obviously illogical, circular and misleading.

13 **Q. DOES THIS COMPLETE YOUR DIRECT TESTIMONY?**

14 A. Yes, this completes my testimony.

County of OKLAHOMA)
State of OKLAHOMA)

AFFIDAVIT OF DONALD A. MURRY

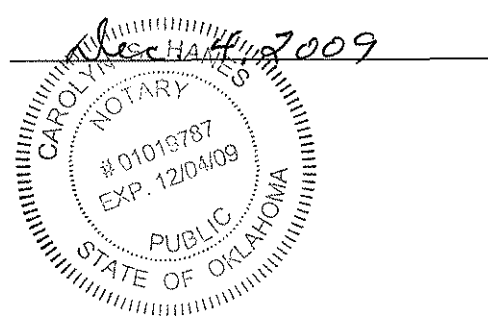
Donald A. Murry, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony, that said testimony was prepared by him and under his direction and supervision; that if inquiries were made as to the facts in said testimony and schedules, he would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his knowledge, information, and belief.

Donald A. Murry
Donald A. Murry

Subscribed and sworn to before me this 19th day of February, 2007.

Carolyn S. Hares
Notary Public # 01019787

My Commission expires:



List of Schedules

Schedule 1: History of Short-Term Debt

Schedule 2: Chart of Short-Term Debt Balances

Schedule 3: Woolridge Proxy Group Returns on Common Equity

Schedule 4: Measures of Risk

Schedule 5: Return on Equity Judgments in 2006

Schedule 6: Chart of the Growth in Real Earnings of the S&P 500

Schedule 7: Assumed Returns on Equity in Woolridge's Internal Growth Rate
Discounted Cash Flow Model

Atmos Energy Corporation

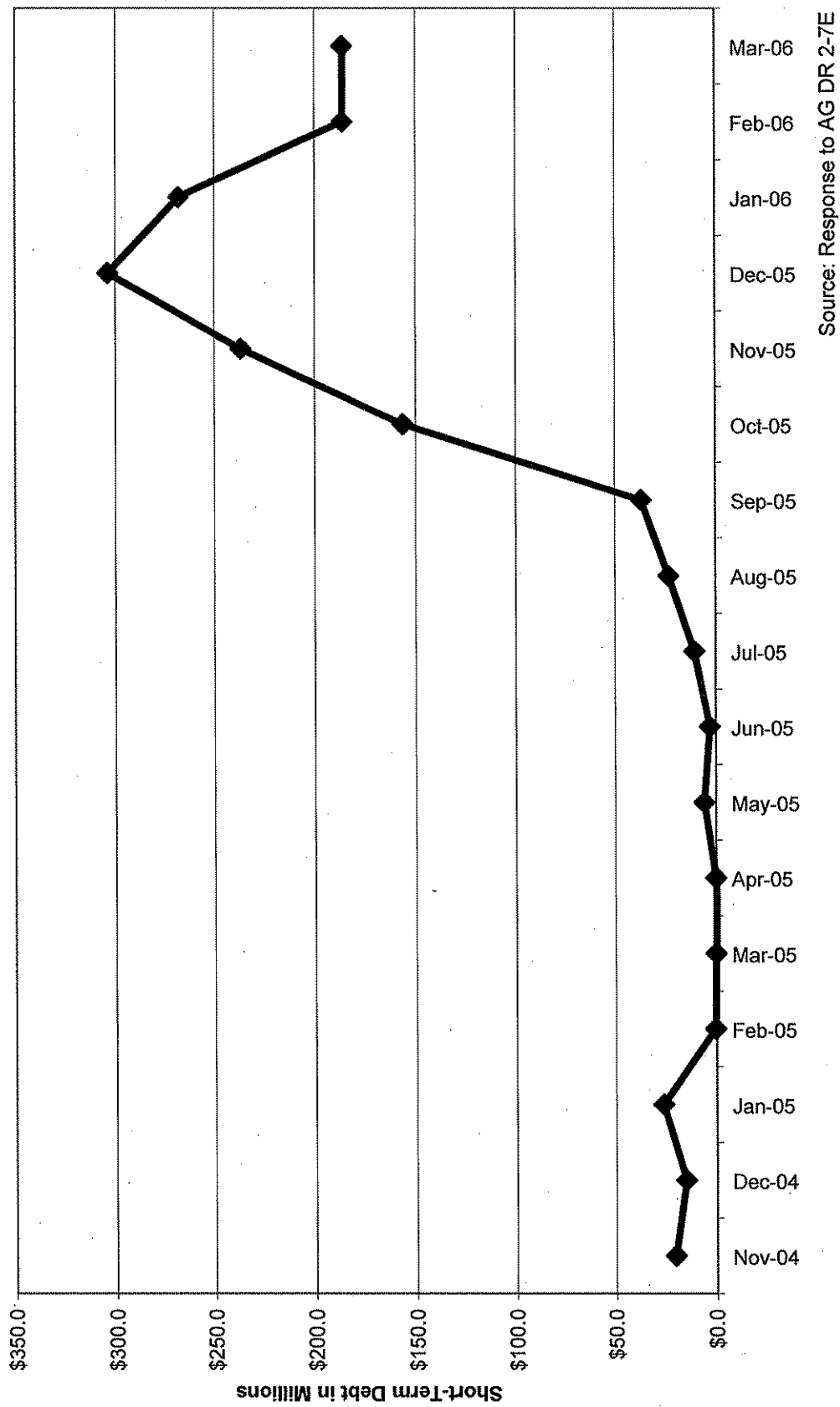
History of Short-Term Debt

Average Daily Balances

Month	Short-Term Debt
Nov-04	\$20,570,000
Dec-04	\$15,231,452
Jan-05	\$26,440,323
Feb-05	\$325,893
Mar-05	\$0
Apr-05	\$0
May-05	\$5,857,258
Jun-05	\$3,000,000
Jul-05	\$10,569,355
Aug-05	\$23,514,032
Sep-05	\$36,963,333
Oct-05	\$156,300,161
Nov-05	\$236,930,933
Dec-05	\$303,849,194
Jan-06	\$268,228,226
Feb-06	\$186,207,821
Mar-06	\$186,226,613

Source: Response to AG 2-7E

**Atmos Energy Corporation
Short-Term Debt Balance**



Atmos Energy Corporation

Woolridge Proxy Group

Returns on Common Stock Equity

Company	Return on Equity
AGL Resources	14.2%
Cascade Natural Gas	15.1%
KeySpan Corp.	8.4%
Laclede Group, Inc.	12.1%
NICOR, Inc.	16.9%
Northwest Natural Gas Co	9.7%
Peoples Energy Corp.	2.1%
Piedmont Natural Gas, Inc.	11.4%
South Jersey Industries	12.4%
Southwest Gas	7.2%
WGL Holdings, Inc.	8.6%
Atmos Energy	8.8%
Mean	10.7%
Median	11.4%

Source: Exhibit JRW-3, page 1 of 1, The Direct Testimony of Dr. J. Randall Woolridge

Atmos Energy Corporation

Woolridge Proxy Group

Measures of Risk

Company	S&P Bond Rating	Pre-Tax Interest Coverage	Common Equity Ratios	Return on Equity
AGL Resources	A-	4.4	45.0%	14.2%
Cascade Natural Gas	BBB+	2.3	43.0%	15.1%
KeySpan Corp.	A+	3.4	50.0%	8.4%
Laclede Group, Inc.	A	3.0	38.0%	12.1%
NICOR, Inc.	AA	4.0	58.0%	16.9%
Northwest Natural Gas Co	AA-	3.4	52.0%	9.7%
Peoples Energy Corp.	A-	1.4	44.0%	2.1%
Piedmont Natural Gas, Inc.	A	4.5	51.0%	11.4%
South Jersey Industries	A	5.0	48.0%	12.4%
Southwest Gas	BBB-	1.9	38.0%	7.2%
WGL Holdings, Inc.	AA-	4.6	54.0%	8.6%
Atmos Energy	BBB	2.6	41.0%	8.8%
Mean	A	3.4	47.4%	10.7%
Median	A	3.4	48.0%	11.4%

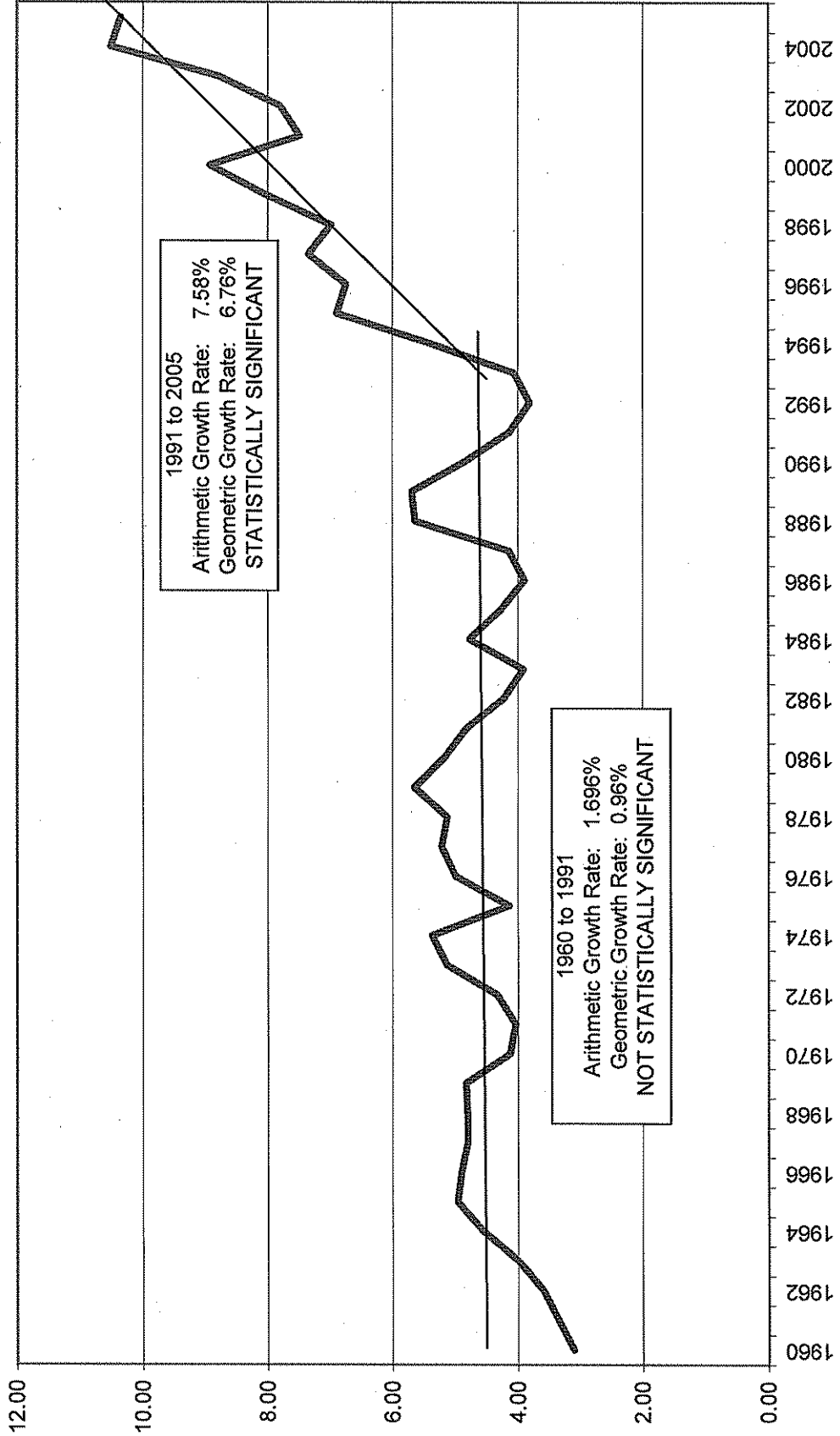
Source: Exhibit JRW-3, page 1 of 1, The Direct Testimony of J. Randall Woolridge

Atmos Energy Corporation
2006 Return on Equity Awards
Local Distribution Companies

Company	State	Date	Return on Equity
Northern States Power	WI	January 5, 2006	11.00%
Wisconsin Electric Power	WI	January 25, 2006	11.20%
Wisconsin Gas	WI	January 25, 2006	11.20%
Public Service of Colorado	CO	February 3, 2006	10.50%
Southwest Gas	AZ	February 23, 2006	9.50%
Aquila Networks	IA	March 1, 2006	10.40%
Sierra Pacific Power	NV	April 26, 2006	10.60%
Louisiana Gas Service/ TransLA Gas	LA	May 25, 2006	10.40%
Questar Gas	UT	May 26, 2006	---
Average			10.60%

Source: RRA's Regulatory Focus, July 6, 2006

Real Earnings Per Share Growth of the Standard & Poor's 500



Source: Schedule JRW-8, page 5 of 5 of the Direct Testimony of Dr. J. Randall Woolridge

Real S&P 500 EPS

Atmos Energy Corporation

Woolridge Proxy Group

Internal Growth Rate DCF Equity Cost Rate

Company	Assumed Return on Equity
AGL Resources	12.0%
Cascade Natural Gas	9.0%
KeySpan Corp.	9.5%
Laclede Group, Inc.	12.0%
NICOR, Inc.	13.5%
Northwest Natural Gas Co	10.5%
Peoples Energy Corp.	14.5%
Piedmont Natural Gas, Inc.	12.5%
South Jersey Industries	13.0%
Southwest Gas	9.5%
WGL Holdings, Inc.	11.0%
Atmos	10.5%
Mean	11.5%
Median	12.0%

Source: Exhibit JRW-7, page 4 of 5, The Direct
Testimony of J. Randall Woolridge