

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

JUN 01 2004

THE FIRST REPORT OF ATMOS ENERGY)
CORPORATION ON ITS HEDGING PROGRAM)
FOR THE 2003-2004 HEATING SEASON AND)
MOTION TO CONDUCT A HEDGING PROGRAM)
FOR THE 2004-2005 HEATING SEASON)

PUBLIC SERVICE
COMMISSION

Case No. 2004-00142

COMMENTS OF THE ATTORNEY GENERAL

Atmos proposes a winter hedging plan for 2004-2005 that is similar to the proposals for the past three years both in the nature of the financial instruments to be used and in the amount of gas to be hedged. This plan differs from prior plans only in the fact that it contains no floor or minimum volume to be hedged. Realistically, however, Atmos expects to do at least some hedging if the Commission approves a hedging plan. It appears realistic to expect that most of the proposed volumes will be hedged absent a significant and early downturn in gas prices, and there appears to be little realistic hope of that event happening.

The hedging effort for the 2003-2004 season is labeled a success, by Atmos, at stabilizing prices and produced a small net benefit to the consumer. The year, however, saw the highest gas prices experienced by consumers and is expected to be repeated or topped in pricing in the winter of 2004-2005.

Atmos has a contract in place under which it purchases its full requirements from an agent, its asset manager, for a price that is fixed under the contract at a discount from various short-term market indices. This contract flows from the approved PBR which itself encourages Atmos to do least cost purchasing in a short term market. As a result of the construction of the PBR and the consequent contract with its agent, Atmos is encouraged to remain in the very market that is producing the price spikes and volatility that hedging is designed to prevent. Given

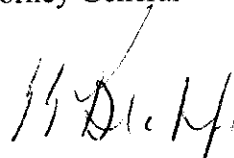
the construction of the PBR and the contract for the supply of Atmos's full requirements, the consumer pays for "shared savings" under the PBR for all gas purchased.

In a volatile market, the least-cost pricing encouraged and rewarded by Atmos's PBR conflicts with the goal of volatility reduction and the avoidance of price spikes brought about by purchasing and/or pricing in a short-term market. Therefore, any hedging done will act to reduce the negative impact for consumers of the purchasing practice encouraged by the PBR. The consumer will be charged both to encourage the purchasing/pricing practice and to protect themselves from the effect of the practice. Under this circumstance, hedging should be approved only if a cost/benefit analysis makes it clear that the consumer will not be paying more in hedging costs plus shared savings plus gas costs than the consumer would pay absent both the incentive provided by the PBR and the protection provided by the hedging program.

Atmos's filing does not present a basis on which to make such a finding. To encourage staying in a volatile market on the one hand, while putting the consumer in the position of protecting himself from that volatility with insurance that costs more than the benefits it has provided does not seem in any way cost-effective. Therefore, the Attorney General recommends that no hedging program be approved. If any hedging program is approved, it should be much smaller than the program proposed. Further, the Attorney General recommends that if a program is approved, mechanistic purchasing of the hedges be discouraged. Finally, if a hedging program is approved, the Attorney General recommends that some portion of the cost of the program be assigned to Atmos in recognition of the fact that the hedge is designed to protect the consumer against the practice which Atmos has been and will continue to be encouraged to pursue and profit from under the PBR in the winter of 2004-2005.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing comments, filed this the 1st day of June, 2004, with the Executive Director of the Public Service Commission at 211 Sower Boulevard, Frankfort, Kentucky, were served on the following by postage prepaid mail:

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