JOHN N. HUGHES
ATTORNEY AT LAW
PROFESSIONAL SERVICE CORPORATION
124 WEST TODD STREET
FRANKFORT, KENTUCKY 40601

TELEPHONE: (502) 227-7270 JNHUGHES@fewpb.net TELEFAX (502) 875-7059

August 22, 2007

Ms. Beth O'Donnell
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40601

Re: Surcharge Options

Dear Ms. O'Donnell:

Atmos Energy Company provides these comments in response to the Commission's meeting of August 16, 2007, dealing with the issues raised by the Order and Opinion of the Franklin Circuit Court, Case No. 06-CI-269, entered Aug. 1, 2007. Of the three options outlined during the meeting only option one, which is for the Commission to proceed with cases as usual, pending the final outcome of the appeals process is reasonable. This option recognizes the proper status of that decision and maintains the regulatory oversight exercised by the Commission for decades. To upend that regulatory stability because of this circuit court decision gives it far greater authority than legally appropriate and creates far too many unknown consequences for the utility industry, not to mention the potential harm to customers. Atmos reiterates and supports the comments by LG&E and KU, which have been filed in this matter as well as the comments made by the representatives of the utility group at the August 16th meeting.

The impact of the other two options - suspend consideration of all "automatic" recovery mechanisms, and continue to process cases involving such recovery mechanisms, but make any prospective recoveries subject to refund are potentially very disruptive to the financial stability of the company and will create unintended hardships on the customers. Without the moderating effect of the Gas Cost Recovery mechanism, for example, customers could face unnecessarily high gas costs for the interim periods between rate cases.

The Company cannot precisely quantify the monetary impact of the Court's decision on each of its current rate adjustment mechanisms, but estimates that approximately 76% of the Company's revenue is generated through these mechanisms. The administrative costs associated with the loss of these interim adjustment mechanisms would also greatly increase. Of course, those costs would be reflected in the form of unnecessarily higher rates to our customers.

The following description of those mechanisms includes the effect of the loss of the program on the Company and customers:

PBR - the philosophy of this mechanism is to provide incentives/penalties to the company for variances from a market-basket of indices assumed to reflect the "market" cost of supply. Any option other than the first would appear to render the PBR useless, since it depends on a formulaic approach to compare actual supply/transportation costs to the market benchmark. Building an effective incentive mechanism on a static basis in a rate case would be difficult if not impossible. The impact of nullifying a PBR would eliminate the company's incentives to take measured risks to lower overall gas supply costs. It is important to note that, although the Company has performed well under the PBR incentives, it is the customers who have realized 2/3+ of the overall PBR savings. In other words, although the Company could lose significant margin - the customers gas cost would potentially increase by more than twice that amount.

WNA - Weather normalization is intended to stabilize customer billings and company margins by eliminating the impacts of weather-driven volume changes. Over time the WNA is expected to zero out - but during any given period without WNA either the Company or customer may lose due to variances in winter temperatures from "normal".

GCA - Gas costs recovered through the GCA constitute more than 74% of the Company's total revenue. As gas costs vary from this current level, customers or shareholders bear the financial risks of such variances. Obviously, gas costs can swing greatly in this highly volatile market. Even though Atmos Energy could realize significant financial gain if gas prices fall, it is likely bond rating agencies and financial markets would frown upon such risks. There also would be an increase in the Company's use of short term debt, which would have a direct impact on its revenue requirement.

Interestingly, for each of the 3 above items (also the three most significant costs recovered through surcharges) the customers bear at least as much risk of cost increase as the shareholders risk in margin loss. The GCA dwarfs the other risks however. A relatively small variance from our current GCA could double our approved gross margin (if G/C goes down) or negate all of our approved (if G/C goes up). Of course, a much lesser swing would offset our total net margin. With such significant volatility introduced by gas cost swings, the costs of litigation and frequency of rate treatment are unimaginable. The impact on debt for unrecovered gas costs also would be significant. Again, Wall Street would view increased risks negatively.

Lastly, the other two surcharges (DSM and R&D) merely collect dollars attributed to a low-income weatherization program and Research & Development efforts. Any option other than the first would likely mean the company would terminate participation in those programs until such time as those costs would be rolled into a general rate case.

Atmos would like to thank the Commission for its interest in this matter that potentially could have a wide-spread impact on the regulatory relationship among the Commission and all utility groups. The Company is willing to work with the Commission and other utilities to resolve this situation created by certain interpretations of the Franklin Circuit Court decision.

Submitted by:
John N. Hughes

Attorney for Atmos Energy Corporation