

# Memorandum



CITY OF DALLAS

Date March 20, 2009

To Members of the Finance, Audit & Accountability Committee  
Chair Mitchell Rasansky, Vice Chair Jerry R. Allen, Mayor Pro Tem Dr. Elba Garcia,  
Vonciel Jones Hill, Angela Hunt, Ron Natinsky and David Neumann

Subject **Atmos Energy Corporation Municipal Gas Rate**

The Committee's March 23<sup>rd</sup> agenda includes a briefing on subject listed above.  
Materials are attached for your review.

Should you require additional information, please let me know.

A handwritten signature in black ink, appearing to read 'D. Cook'.

David Cook  
Chief Financial Officer

C: Honorable Mayor & Members of the City Council  
Mary K Suhm, City Manager  
Tom Perkins, Jr., City Attorney  
Deborah Watkins, City Secretary  
Craig Kinton, City Auditor  
Ryan S. Evans, First Assistant City Manager  
Forest E. Turner, Interim Assistant City Manager  
Ramon Miguez, P.E., Assistant City Manager  
Jill A. Jordan, P.E., Assistant City Manager  
A.C. Gonzalez, Assistant City Manager



# Atmos Energy Corporation Municipal Gas Rate Case

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Finance, Audit & Accountability  
Committee Briefing

March 23, 2009



# Purpose

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- Advise Council of:
  - Atmos Energy Corporation's Statement of Intent to Change Rates in the Atmos Energy Corp., Mid-Tex Division Gas Utility System
  - Consultant's findings
  - City Manager's recommendation



# Background

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- Franchise Ordinance authorizes Atmos Energy Corporation (Atmos) to provide natural gas utility service in Dallas
- Texas Utilities Code
  - City has original jurisdiction for distribution rates
  - The Railroad Commission of Texas (RCT) has appellate jurisdiction



# Background (Continued)

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- Gas bill components
  - City Gate Rate usage charge
    - Approved by RCT
    - Cost from producer and transmission company to City limits
    - Includes the cost of gas
    - The City Gate Rate typically comprises 70% of residential charges and 80% of commercial charges



# Background (Continued)

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- Local distribution charges
  - Approved by City
  - Charges for distribution from “City limits” to customers
  - Monthly customer charge
  - Local usage charge



# Background (Continued)

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- Four billing classes
  - Residential
  - Commercial
    - Businesses and apartments with gas for common use
  - Industrial
    - Contract for a minimum of 125 Mcf per month
    - Service may be interrupted in extreme conditions
  - Transport
    - Fee charged to transport gas between two other parties



# Background (Continued)

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- Rate setting process
  - On November 5, 2008 Atmos filed its notice of intent to increase gas rates with a proposed effective date of December 11, 2009
  - Original period of 35 days to render decision or extend the deadline an additional 90 days (125 days total)





# Background (Continued)

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- Rate setting process (Continued)
  - Deadline was extended for additional 90 days on December 10, 2008 Resolution #08-3347
  - On February 19, 2009, Atmos extended the proposed effective date by 15 days
  - Deadline to take action on the current rate filing is now March 26, 2009
    - Deadline may only be extended further by mutual agreement of City and Atmos



# Background (Continued)

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- Current Authorized Rates
  - Rates currently authorized to be charged by Atmos were set June 25, 2008 by the Railroad Commission of Texas in GUD 9762
    - Rates were set on a system wide basis to be charged in Dallas and the environs
  - GUD 9762 is presently on appeal in Travis County District Court
    - The City of Dallas is participating in that appeal
    - Prior Case, GUD 9670 is also still on appeal



# Background (Continued)

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- Current Rates being charged by Atmos include a Gas Reliability Infrastructure Program (GRIP) increase
  - GRIP allows interim rate increases based on increases in net investment in plant
  - Atmos filed its amended 2007 GRIP adjustment with the City on August 1, 2008
  - City denied the GRIP adjustment November 10, 2008 by Ordinance #27409
  - RCT refused to hear the GRIP appeal
  - Atmos implemented the GRIP increase January 23, 2009 without regulatory approval

# Background (Continued)

## ■ Results of Recent system wide Atmos Gas Cases

Date Filed	Docket No.	Requested Increase	Increase Granted by RCT	Percent of Request Granted
May 03	GUD 9400	\$61.6 M	\$2.0	3.27%
Jun 06	GUD 9670	\$59.8 M	\$5.0	8.43%
Oct 07	GUD 9762	\$46.9 M	\$19.7	41.90%
Nov 08	Current Case	\$57.8 M		



# Current Filing

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- Atmos has filed this case with the City of Dallas only
  - The Case was filed on a system wide basis with total system costs
  - The rates will only be charged in the City of Dallas



# Current Filing Continued

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- Atmos is seeking an increase in revenues of \$57.8 million from all ratepayers
  - Residential Base Revenue increase 14.48%
  - Commercial Base Revenue increase 16.53%
  - Industrial/Transportation Base Revenue increase 19.1%
  - Service Charge Revenue unchanged
  - Total Base revenue increase 15.10%



# Current Filing Continued

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- Staff and outside legal counsel have determined that it is appropriate for the City to set rates in this matter
- The City retained Diversified Utility Consultants to review the rate filing and recommend rates to be set by the City
  - Contract approved December 10, 2008 by resolution #08-3348



# Consultants' Findings

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- Diversified Utility Consultants, Inc. (DUCI) issued its report to the City on February 6, 2009 (copy attached)
- DUCI identified several areas of concern with the rate request
  - Major issues explained on the following pages (impact amounts are approximate)
  - Other minor issues are in report, but not explained here





# Consultants' Findings Continued

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- Return on Common Equity (ROE)
  - Atmos requested a ROE of 11.7%
  - On 6/25/2008 the RCT granted an ROE of 10% in the last Atmos case (GUD 9762)
  - Interest rates have declined since that time (US Treasury 10 Year Notes declined 56%)
  - DUCI recommends a ROE of 9.67%
  - Recommended change in ROE reduces the revenue requirement by \$22.1 million



# Consultants' Findings Continued

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- Capital Structure

- RCT used a capital structure of 51.73% debt and 48.27% equity in GUD 9762 less than one year ago
  - Issue was fully litigated in that case
- Atmos is requesting a capital structure of 50.18% debt and 49.82% equity
  - Increasing the equity percentage increases the revenue requirement
- DUCI recommends using the capital structure approved by the RCT less than one year ago
  - Recommended change reduces the revenue requirement by \$2.6 million



# Consultants' Findings Continued

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- Plant in Service

- This case uses a test year ending June 30, 2008
- Atmos made an adjustment to net plant in service at year end of \$80.9 million
  - Adjustment is for plant expected to be placed in service between 6/30/2008 and 3/31/2009
  - Adjustment is based on budgeted amounts
- DUCI recommends removing the proposed adjustment
  - Net Plant was the only element of Rate Base that was adjusted for changes 9 months beyond the test year
  - Adjustment to plant is not known and measurable
  - Recommended change in net Plant in Service reduces the revenue requirement by \$15.9 million



# Consultants' Findings Continued

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- Cash Working Capital (CWC)
  - RCT ordered a negative CWC of \$41.6 million in GUD 9762 less than one year ago
  - Atmos is requesting a negative CWC in this filing of \$33.2 million
  - DUCI made two adjustments to CWC and recommends a CWC of negative \$40.9 million
    - DUCI made changes to revenue lag and expense lead consistent with GUD 9762
    - Recommended change in CWC reduces the revenue requirement by \$1.0 million



# Consultants' Findings Continued

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- Accumulated Deferred Federal Income Tax (ADFIT)
  - Per Atmos books test year end level of ADFIT was \$79.3 Million
  - Atmos made numerous adjustments to ADFIT resulting in a reduction of \$34.4 Million
  - DUCI made several adjustments to the calculated ADFIT
    - Recommended change in ADFIT reduces the revenue requirement by \$1.8 million



# Consultants' Findings Continued

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- Payroll Expense – Incentive Compensation
  - Incentive payments are based on financial goals to enhance the Company's profits
  - Additional profits benefit owners and not rate payers and thus, this expense is not appropriate to include in rates
  - RCT ruled to remove incentive compensation in Atmos' last rate case GUD 9762
  - Recommended change in rate treatment of Incentive Compensation reduces the revenue requirement by \$5.8 million



# Consultants' Findings Continued

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- Merit Increases

- Atmos adjusted its base payroll expense for future merit increases of 3.5% that may be awarded post test year
- Rates are set on historic costs adjusted for known and measurable changes
  - This proposal does not meet the known and measurable standard
- Across the country many employers are cutting back, laying off employees and freezing or cutting salaries
- DUCI recommends disallowing the proposed merit increases
- Recommended change in Merit Increases reduces the revenue requirement by \$1.7 million
  - Employee Benefits expense is also reduced by \$0.5 million



# Consultants' Findings Continued

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- Call Center Expense
  - Atmos operates two different call centers in Texas
    - Allocation of the costs for the two call centers has been fully litigated in the prior cases
    - Atmos changed the way it allocates costs of the call centers from prior cases and created new cost centers to assign costs previously in call centers
  - Because of changed circumstances DUCI recommends allocating call centers on the same basis as other "Shared Services"
  - Recommended change call center allocation reduces the revenue requirement by \$2.9 million





# Consultants' Findings Continued

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- Uncollectible Expense
  - Atmos used 3 year average of uncollectible expense (consistent with GUD 9762)
  - Write-offs unusually high for 2006
  - Atmos recently implemented a stronger collection effort to reduce bad debts
  - Current gas prices are lower than in years past
  - DUCI Recommends using 2 year average to account for new collection efforts and reduced gas cost
    - Recommended change in Uncollectible Expense reduces the revenue requirement by \$1.3 million



# Consultants' Findings Continued

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- Depreciation
  - Atmos included depreciation expense for three sub accounts in excess of what is necessary to recover investment
    - Accounts were almost fully depreciated at test year end
    - One account was fully depreciated one month after test year end (July 2008)
  - DUCI adjusted Depreciation expense to recognize the proper relationship between the remaining balance to be recovered and the Company's annual depreciation request set forth in the revenue requirement
- Recommended change in Depreciation Expense reduces the revenue requirement by \$1.1 million



# Consultants' Findings Continued

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- The combination of the various rate base, return and expense adjustments results in a rate decrease being warranted
- A base rate decrease of approximately \$61.4 million from Atmos' request is warranted based on these adjustments
- This is a 1.0% decrease from current rates
  - Rates are contained in the following table



# Consultants' Findings Continued

## COMPARISON OF AUTHORIZED, CURRENT, PROPOSED AND RECOMMENDED TARIFF RATES FOR RESIDENTIAL AND COMERCIAL CUSTOMERS

	<b>Current Authorized Rates</b>	<b>Current Rates Being Charged</b>	<b>Atmos Energy Requested Rates</b>	<b>Consultant Recommended Rates</b>
Residential Rates				
<b>Customer Charge</b>	<b>\$14.00</b>	<b>\$14.48</b>	<b>\$16.00</b>	<b>\$14.00</b>
<b>Amount per Mcf</b>	<b>\$0.6164</b>	<b>\$0.6164</b>	<b>\$0.7104</b>	<b>\$0.5826</b>
Commercial rates				
<b>Customer Charge</b>	<b>\$25.00</b>	<b>\$26.23</b>	<b>\$30.00</b>	<b>\$25.00</b>
<b>Amount per Mcf</b>	<b>\$0.6109</b>	<b>\$0.6109</b>	<b>\$0.6940</b>	<b>\$0.5987</b>



# Consultants' Findings Continued

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## COMPARISON OF CURRENT, PROPOSED AND CONSULTANT RECOMMENDED TARIFF RATES FOR INDUSTRIAL CUSTOMERS

	Current Authorized Rates	Current Rates being Charged	Atmos Energy Requested Rates	Consultant Recommended Rates
<b>Customer Charge</b>	<b>\$450.00</b>	<b>\$473.26</b>	<b>\$550.00</b>	<b>\$450.00</b>
<b>Consumption Charge/MMBTU</b>				
<b>First 1,500 MMBTU</b>	<b>\$0.2200</b>	<b>\$0.2200</b>	<b>\$0.2552</b>	<b>\$0.2158</b>
<b>Next 3,500 MMBTU</b>	<b>\$0.1600</b>	<b>\$0.1600</b>	<b>\$0.1856</b>	<b>\$0.1569</b>
<b>Over 5,000 MMBTU</b>	<b>\$0.0255</b>	<b>\$0.0255</b>	<b>\$0.0296</b>	<b>\$0.0250</b>



# Current Filing Negotiations

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- Staff met with Atmos to share consultant's findings on February 9, 2009
- Staff and Atmos met numerous times since February 9, 2009 to negotiate a settlement of this rate case
- Unable to reach agreement with Atmos on appropriate rates to be charged in the City of Dallas



# Options Available to City

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1. Approve rates requested by Atmos
2. Set rates as recommended by DUCI
3. Deny the rate increase (current rates would remain in effect)
4. Take No action (rates as requested would be deemed approved)
5. Set rates at some other level as determined by City Council



# City Manager's Recommendation

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- Adopt rates as recommended by Consultant (DUCI)





# What's Next

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- March 25, 2009 – Adopt Ordinance setting rates for Atmos
- March 26, 2009 – Deadline to take action on rates or they become approved by operation of law