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Issue: Rate of Return

Witness: Matthew J. Barnes

Sponsoring Party: MoPSC Staff

Type of Exhibit: Surrebuttal Testimony

Case No.: GR-2006-0387

Date Testimony Prepared: November 13, 2006

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

MATTHEW J. BARNES

ATMOS ENERGY CORPORATION

CASE NO. GR-2006-0387

Staff Exhibit No. 102
Case No(s) GR-2006-0387
Date 11-30-06 Rptr PF

Jefferson City, Missouri
November 2006

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Atmos Energy Corporation's Tariff)
Revision Designed to Consolidate Rates and)
Implement a General Rate Increase for Natural Gas)
Service in the Missouri Service Area of the)
Company.

Case No. GR-2006-0387

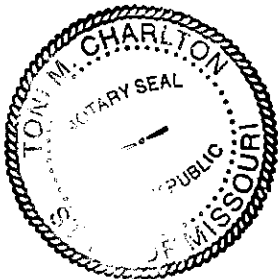
AFFIDAVIT OF MATTHEW J. BARNES

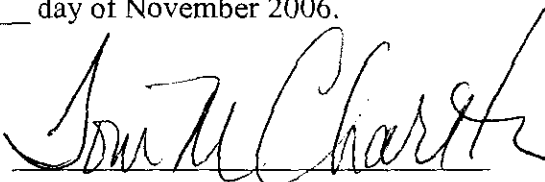
STATE OF MISSOURI)
)
COUNTY OF COLE) ss.

Matthew J. Barnes, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Surrebuttal Testimony in question and answer form, consisting of 3 pages to be presented in the above case; that the answers in the foregoing Surrebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.


Matthew J. Barnes

Subscribed and sworn to before me this 9th day of November 2006.





TONI M. CHARLTON
Notary Public - State of Missouri
My Commission Expires December 28, 2008
Cole County
Commission #04474301

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MATTHEW J. BARNES
ATMOS ENERGY CORPORATION
CASE NO. GR-2006-0387

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EXECUTIVE SUMMARY

Q. Please summarize Mr. Trippensee's recommended cost of common equity for Atmos.

A. Mr. Trippensee recommends to the Commission a cost of common equity for Atmos of 7.00 percent. Mr. Trippensee's recommendation is not supported by a commonly accepted rate of return analysis. He did not analyze the cost of common equity of companies that may have similar risk characteristics as those that may be in effect for Atmos' Missouri operations if the Company's or Staff's rate design proposal is accepted. In fact, he did not even recognize that many of my comparable companies have weather mitigation rate designs that minimize risks related to changes in the weather. Mr. Trippensee's methodology is not supported by any authoritative sources regarding a cost of capital analysis. As far as Staff is aware his methodology has never been presented to the Commission.

MR. TRIPPENSEE'S RECOMMENDED COST OF COMMON EQUITY FOR ATMOS

Q. How did Mr. Trippensee arrive at the cost of common equity of 7.00 percent for Atmos?

A. Mr. Trippensee states in his rebuttal testimony beginning on page 11, lines 18 through line 22:

Yes. Public Counsel would recommend the Commission use a 7% return on equity. Public Counsel's recommendation utilizes the spread (.87%) between the risk-free rate (5.13%, Barnes Direct, page 16, lines 17-20) and cost of debt (6.03%, Barnes Direct, Schedule 21) and incorporates that spread between the cost of debt and its equity recommendation with the result (6.03% + .87%=6.90%) rounded up to 7%.

1 Q. Is it appropriate to use a current risk-free rate to subtract from a historical
2 embedded cost of debt?

3 A. No. The risk-free rate is a recent market rate and the embedded cost of debt is
4 a rate based upon the cost of historical debt issuances. It is not appropriate for
5 Mr. Trippensee to compare recent market yields with an historical embedded cost of debt.
6 This is an apples to oranges comparison.

7 Q. Has Mr. Trippensee prepared a detailed cost of capital analysis to support his
8 recommendation for a cost of common equity of 7.00 percent for Atmos?

9 A. No. Mr. Trippensee has not prepared such an analysis to support his
10 recommended cost of common equity of 7.00 percent for Atmos. Mr. Trippensee merely
11 uses the difference between the risk-free rate and the embedded cost of long-term debt for
12 Atmos and adds the difference to the embedded cost of long-term debt to arrive at a cost of
13 common equity of 7.00 percent, which as I mentioned previously is inappropriate.

14 Q. Does Mr. Trippensee provide any citations from financial literature to support
15 his recommended method of calculating the return on equity?

16 A. No.

17 Q. Has Staff ever seen Mr. Trippensee's methodology presented to the
18 Commission?

19 A. No.

20 Q. Does Staff's proposed rate design reduce the business risk of Atmos?

21 A. All else being equal yes, Staff's rate design proposal does reduce the business
22 risk of Atmos.

1 Q. In this case, did Staff recommend an adjustment downward to the cost of
2 common equity due to Staff's rate design proposal?

3 A. No. Staff did not recommend an adjustment downward to the cost of common
4 equity due to Staff's proposed rate design method. Staff's comparable company analysis
5 indirectly takes into consideration the rate design that is reflected in each company's credit
6 rating. In Schedule 19 in my direct testimony I calculated the average credit rating of my
7 proxy group. The average credit rating is 'A'. Staff analyzed research reports from Standard
8 and Poor's and Value Line Investment Survey and determined that 7 out of 8 companies in
9 Staff's proxy group have a rate design in effect that mitigates the effect of weather on the
10 recovery of fixed costs. Staff believes that if these rate designs were as advantageous as
11 Mr. Trippensee implies from his 7.0 percent ROE recommendation, my analysis of the cost
12 of capital, based on these comparable companies, would have shown that investors would
13 require a lower return on common equity. However, my analysis shows that the cost of
14 capital should be between 8.59% and 9.39%.

15 Peoples Energy Corporation (Peoples) is the only company in my proxy group that
16 does not have a rate design in effect that would mitigate the effects of weather on the
17 recovery of fixed costs. However, Peoples currently has a credit rating of 'A-', which is in
18 the same category as my proxy group average. This implies that even though Peoples does
19 not have a rate design that protects it from risks related to weather, its overall risk profile is
20 similar to the average risk profile of my comparable companies. It is the aggregate risk
21 profile of the company that is most relevant in a cost of common equity analysis.

22 Staff recommends that if the Commission adopts Staff's proposed rate design and it is
23 inclined to reduce the cost of common equity for Atmos, as a result they should move to the

1 lower end of the range of return on equity that the Commission decides is reasonable in this
2 case. Staff's recommended range for the cost of equity remains at 8.59 percent to 9.39
3 percent.

4 **SUMMARY AND CONCLUSIONS**

5 Q. Please summarize the conclusions of your surrebuttal testimony.

6 A. My conclusions regarding the cost of common equity are listed below.

7 1. Mr. Trippensee does not provide any evidence or analysis that
8 supports his recommendation of 7.00 percent for Atmos. His
9 methodology to determine the cost of common equity for Atmos does not
10 meet the traditional requirements to establish a return on equity. Staff
11 does not support the methodology or the resulting return on equity
12 recommended by Mr. Trippensee.

13 2. Staff's recommended return on common equity of 8.59 percent to 9.39
14 percent would produce a fair and reasonable return on rate base of 7.12
15 percent to 7.46 percent for Atmos. My recommendation is supported by
16 my analysis attached to my direct testimony and does in fact take into
17 consideration a rate design that accounts for the reduction in risk for
18 Atmos.

19 Q. Does this conclude your surrebuttal testimony?

20 A. Yes, it does.