

MODEL STAFF REPORT

The City, along with 150 other cities served by Atmos Energy Mid-Tex Division ("Atmos Mid-Tex" or "Company"), is a member of the Atmos Cities Steering Committee ("ACSC" or "Steering Committee"). On March 6, 2009, Atmos Mid-Tex filed with the City an application to increase natural gas rates pursuant to the Rate Review Mechanism ("RRM") tariff approved by the City as part of the settlement of the Atmos Mid-Tex 2007 Statement of Intent to increase rates.

The Atmos Mid-Tex March RRM filing sought a \$20.2 million rate increase. The City worked with ACSC to analyze the schedules and evidence offered by Atmos Mid-Tex to support its request to increase rates. The Ordinance and attached RRM tariff are the result of negotiation between ACSC and the Company to resolve issues raised by ACSC during the review and evaluation of ACSC's RRM filing. The Ordinance and RRM tariffs approve rates that will increase the Company's revenues by \$2.6 million effective for bills rendered on or after August 1, 2009. The monthly bill impact for the average residential customer will be a \$0.15 increase (about a 0.22% increase in the total bill).

Please note that current rates contain a true-up component (\$9 million to be collected over twelve months) from the first RRM in 2008. Collection of the 2008 true-up amount is scheduled to end on November 1, 2009. The rate impact of that 2008 true-up amount for the period August 1 – October 31, 2009 is \$1,006,073. To simplify the process and to reduce rate fluctuations, the parties have agreed to eliminate collection of the 2008 true-up on August 1, 2009 rather than November 1, 2009. The remaining \$1,006,073 that is still owed from the 2008 true-up will be recovered as part of the 2009 true-up over 12 months rather than 3 months. This change related to the 2008 true-up amount is revenue and rate impact neutral.

The ACSC Executive Committee recommends that all ACSC Cities adopt the Ordinance implementing the rate change.

RRM Background:

The RRM tariff was approved by ACSC Cities as part of the settlement agreement to resolve the Atmos Mid-Tex 2007 rate increase case. Atmos Mid-Tex's current action represents the second filing pursuant to the three-year trial project known as the RRM process. The RRM process was created collaboratively by ACSC and Atmos Mid-Tex as an alternative to the GRIP surcharge process. The RRM process allows for a more comprehensive rate review and annual adjustment that will function as a substitute for future GRIP filings during the three-year trial period specified by the tariff.

There are two components to the RRM adjustment. The prospective component adjusts rates for known and measurable changes in O&M and net plant investment. Atmos Mid-Tex and ACSC agreed to cap changes to expenses and invested capital at no more than 5%. The true-up component evaluates whether the Company has over or underrecovered its earnings for the previous year. For purposes of the RRM true-up component, the Atmos Mid-Tex rate of return on equity and its capital structure are frozen to avoid the parent company from manipulating the overall rate of return. Costs expressly prohibited from recovery through the RRM include first-

class air fare, travel, meals or entertainment for an employee's spouse, alcohol, sports events, entertainment, arts and cultural events, sponsorship of sports, arts or cultural events, and social club membership dues.

Purpose of the Ordinance:

The purpose of the Ordinance is to approve rate tariffs (“Attachment A”) and Proof of Revenues (“Attachment B”) that reflect the negotiated rate change pursuant to the RRM process. In addition to the RRM tariffs, the Ordinance also approves a revision to the Atmos Mid-Tex current Gas Cost Recovery ("GCR") tariff to allow the Company to recover certain hedging costs associated with natural gas futures through the GCR tariff.

As a result of the negotiations, ACSC was able to reduce the Company's requested \$20.2 million RRM increase by more than 70%. Approval of the Ordinance will result in rates that implement a \$2.6 million increase in Atmos' revenues effective August 1, 2009.

Reasons Justifying Approval of the Negotiated Resolution:

During the time that the City has retained original jurisdiction in this case, consultants working on behalf of ACSC cities have investigated the support for the Company's requested rate increase. While the evidence does not support the \$20.2 million increase requested by the Company, ACSC consultants agree that the Company can justify a slight increase in revenues. The agreement on \$2.6 million is a compromise between the positions of the parties.

The alternative to a settlement of the RRM filing would be a contested case proceeding before the Railroad Commission of Texas (“RRC”) on the Company's current application, would take several months and cost ratepayers millions of dollars in rate case expenses and would not likely produce a result more favorable than that to be produced by the settlement. The ACSC Executive Committee recommends that ACSC members take action to approve the Ordinance authorizing new rate tariffs.

With regard to the revision to the GCR tariff, ACSC has advocated that the Company use hedging as a risk management tool to help mitigate volatile natural gas prices. The tariff change is consistent with ACSC's prior position.

Explanation of "Be It Ordained" Paragraphs:

1. This paragraph approves all findings in the Ordinance.
2. This section adopts the attached tariffs (“Attachment A”) and the Company's Proof of Revenues (“Attachment B”) in all respects and finds the rates set pursuant to the attached tariffs to be just, reasonable and in the public interest. Note that only new tariffs or existing tariffs being revised are attached to the Ordinance. Existing tariffs not being changed in any way are not attached to the Ordinance.
3. This section requires the Company to reimburse ACSC for reasonable rate making costs associated with reviewing and processing the RRM application.

4. This section repeals any resolution or ordinance that is inconsistent with this Ordinance.

5. This section finds that the meeting was conducted in compliance with the Texas Open Meetings Act, Texas Government Code, Chapter 551.

6. This section is a savings clause, which provides that if any section(s) is later found to be unconstitutional or invalid, that finding shall not affect, impair or invalidate the remaining provisions of this Ordinance. This section further directs that the remaining provisions of the Ordinance are to be interpreted as if the offending section or clause never existed.

7. This section is a "Most Favored Nations" clause, which protects the City by mandating that if the City determines any rates, revenues, terms and conditions, or benefits resulting from a Final Order or subsequent negotiated settlement approved in any proceeding addressing the issues raised in the Company's RRM filing would be more beneficial to the City than the terms of the attached tariff, then the more favorable rates, revenues, terms and conditions, or benefits shall additionally accrue to the City.

8. This section allows the Company to recover certain costs associated with natural gas hedging through the GCR tariff.

9. This section provides for an effective date upon passage.

10. This paragraph directs that a copy of the signed Ordinance be sent to a representative of the Company and legal counsel for ACSC.