

STATE OF IOWA  
DEPARTMENT OF COMMERCE  
UTILITIES BOARD

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IN RE:  ATMOS ENERGY CORPORATION	DOCKET NO. SPU-07-1
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**ORDER DENYING APPLICATION FOR RECONSIDERATION AND GRANTING  
APPLICATION FOR WAIVER**

(Issued June 28, 2007)

**PROCEDURAL BACKGROUND**

On March 7, 2007, the Utilities Board (Board) issued an order in Docket No. SPU-07-1 finding that the asset management contract entered into by Atmos Energy Corporation (Atmos) for the management of Atmos' gas purchasing assets is a reorganization as described in Iowa Code § 476.76 and directing Atmos to file either a petition for reorganization pursuant to Iowa Code § 476.77(1) or an application for a waiver of review pursuant to Iowa Code § 476.77(4). On April 10, 2007, the Board granted Atmos an extension to make the required filing.

On April 13, 2007, Atmos filed an application for reconsideration and, in the alternative, an application for waiver. On April 18, 2007, the Consumer Advocate Division of the Department of Justice (Consumer Advocate) filed a response. On May 16, 2007, Atmos filed a correction to its April 13, 2007, filing that provided corrections to the calculations in paragraph 23 of the April 13, 2007, pleading.

## APPLICATION FOR RECONSIDERATION

### 1. Atmos's Position

Atmos presents two main arguments in support of its position that the Board's March 7, 2007, decision should be reconsidered. First, Atmos argues that the asset management contract is not a reorganization under Iowa Code § 476.76 and, second, that the asset management contract is exempt under 199 IAC 32.2(3) because it is similar to the listed exempt activities and is engaged in as a part of the ordinary course of business. Atmos argues that it is not disposing of any assets by entering into the asset management contract and therefore the contract does not come within the definition of a reorganization under Iowa Code § 476.76. Atmos points out that under the contract the release of the Atmos pipeline capacity and storage assets is a temporary release only and is always subject to recall by Atmos. The asset manager only has use of the assets when Atmos is not in need of the capacity or storage. Atmos argues this shows that it has not divested itself of the assets, since it always has control of the assets for Iowa customers.

Atmos argues that the asset management contract for gas purchasing assets is not similar to the contract in Docket No. WRU-99-54-151 between Nuclear Management Company (NMC) and IES Utilities, Inc. (IES) and significant differences between the two contracts should justify a different treatment. (The Board cited the decision in Docket No. WRU-99-54-151 in the March 7, 2007, decision.) Atmos suggests that IES gave up the day-to-day operational authority of the Duane Arnold

Energy Center (DAEC) to NMC and IES could cancel the contract without cause only upon one-year notice. Aquila points out that the manager of the capacity under the asset management contract is only entitled to use the capacity subject to Atmos' prior need.

In support of the second argument, Atmos points out that the asset management contract should be exempt under 199 IAC 32.2(3) as a similar transaction to those listed and which occur in the ordinary course of business. Pursuant to subrule 32.2(3), only those transactions involving more than 10 percent of a public utility's gross utility assets less depreciation, or any transaction outside the ordinary course of business are subject to the review of the Board.

Atmos argues that even if the terms "energy and capacity purchases and sales" in subrule 32.2(3) are intended only to apply to electricity and not natural gas capacity release, and natural gas capacity release is not considered a similar transaction, natural gas capacity purchases and sales should be exempt since gas commodity purchases are already exempt. According to Atmos, capacity purchases and sales, as well as capacity subscriptions and releases, are transactions that occur with regularity in the industry and if utilities were required to file reorganization proceedings each time they entered into such transactions, they would be burdened with endless filings. In addition, these transactions are reviewed as part of the annual purchased gas adjustment (PGA) review.

Atmos argues that the asset management plan has been in place since December 2004 and use of an asset management plan is an industrywide practice. Allowing management of transportation and capacity by those most able to do so while at the same time having access to that transportation and capacity when customers need it is an activity in the ordinary course of business, argues Atmos.

## **2. Consumer Advocate's Position**

In its April 18, 2007, response, Consumer Advocate states that it objects to the request for reconsideration filed by Atmos for the reasons set out in the response filed January 19, 2007. In the January 19, 2007, response, Consumer Advocate argued that Atmos provided no evidence as to whether the assets involved fall below the minimum standards established in 199 IAC 32.2(2) and (3) for filing a proposal for reorganization. Atmos addressed these minimum standards in the application for reconsideration.

Consumer Advocate argues that the asset management contract does not qualify for any of the exemptions established in 199 IAC 32.2(3). The subrule specifically exempts only gas purchases, not natural gas capacity purchases and sales. The reference to capacity purchases in the subrule only applies to electric utilities and Consumer Advocate states that the Board will have to interpret whether gas capacity purchases and sales are similar transactions to "gas purchases" or "energy capacity purchases and sales." Consumer Advocate points out that Atmos has ignored the determinative exemption language in 199 IAC 32.2(3), which

provides for the exemption unless the transaction is "outside the ordinary course of business." Atmos addresses this deficiency in its application for reconsideration.

Consumer Advocate then states its disagreement with Atmos' statement that requiring a reorganization filing would frustrate a utility's ability to maximize the value of interstate capacity and storage assets. Consumer Advocate argues that filing a proposal for reorganization as required by the statute and Board rules does not frustrate the utility, rather, it provides for Board review to ensure the proposed reorganization maximizes the value of utility assets at minimum cost to customers.

Finally, Consumer Advocate disagrees with Atmos that a finding that the asset management plan comes within the provisions of Iowa Code § 476.77 would apply statutory asset divestiture and acquisition regulation to assets that have never in fact been divested. Consumer Advocate refers to the Board's decision in Docket No. WRU-99-54-151, in which the Board found it had jurisdiction over a management contract for reorganization filing purposes. Consumer Advocate indicates the Board allowed the utility to file for a waiver of the filing requirements of Iowa Code § 476.77 and 199 IAC 32. Consumer Advocate requests the Board, if it determines it does not have jurisdiction over the asset management plan in question, to inform the rate-regulated utilities that the Board intends to stay informed of all proposed and executed asset management contracts with third parties.

### **3. Board Discussion**

Iowa Code § 476.76 defines "reorganization" as the acquisition, sale, lease, or any other disposition, directly or indirectly, including by merger or consolidation, of the whole or any substantial part of a public utility's assets. Iowa Code § 476.77 states that a reorganization shall not take place if the Board disapproves and requires that prior to reorganization the utility shall file with the Board a proposal for reorganization with supporting testimony and evidence to establish that the reorganization is not contrary to the interests of the public utility's ratepayers and the public interest.

Iowa Code § 476.77(4) provides that the Board may adopt rules which exempt a public utility or class of public utility or class of reorganization from this statutory requirement if the Board determines that review is not necessary in the public interest. This section also provides the Board with the authority to waive the statutory filing requirements if the Board finds that review of a particular transaction is not necessary in the public interest. The Board has promulgated rules in 199 IAC 32.2 that establish thresholds and specific activities for which a proposal for reorganization is not required to be filed.

In the order issued March 7, 2007, the Board found that the asset management contract was an indirect disposition of Atmos' natural gas purchasing assets and was therefore a reorganization under the statute and did not meet the exemptions described in 199 IAC 32.2. The Board directed Atmos to either file a

proposal for reorganization or a request for a waiver. Atmos has filed an application for reconsideration of the decision that the asset management contract is a reorganization as defined by the statute and that it is not exempted under 199 IAC 32.2(3).

The definition of a reorganization in Iowa Code § 476.76 includes not only direct actions taken by a rate-regulated public utility but indirect actions to acquire, sell, lease, or otherwise dispose of the whole or a substantial part of a utility's assets. A public gas utility's gas purchasing assets are a substantial part of the utility's assets since they are the assets used to provide gas to customers.<sup>1</sup> There can be little question that contracting for use of those assets by a third party comes within the definition as an indirect disposition of the assets. The definition includes transactions involving less than complete transfer or divestiture of the utility's assets.

In the March 7, 2007, order, the Board noted that it addressed a similar contract where a regulated utility had entered into a management contract for the operation of a nuclear facility. IES Utilities Inc. and Nuclear Management Company, Docket No. WRU-99-54-151 (SPU-99-33). In that docket, the Board required IES to file a proposal for reorganization before it could enter into a service agreement for the operation, management, maintenance, and repair of DAEC. In the March 7, 2007, order, the Board recognized there were differences between the management contract entered into by IES for the operation of a nuclear facility and the

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<sup>1</sup> See rule 32.2(2), recognizing the need for separate consideration of transactions involving assets used "in the delivery of utility services to Iowa customers."

management contract entered into by Atmos. However, the Board concluded that the same statutory requirements and principles applied to both transactions. In Docket No. WRU-99-54-151, the Board focused on the transfer of the day-to-day operational authority and found that the transfer constituted an indirect transfer of assets and the retention of authority to make certain management decisions was not sufficient to avoid application of the reorganization statutes and rules.

Atmos argues that the asset management contract it has entered into is different than the one entered into by IES since Atmos has retained control of the capacity and storage assets and has only allowed the asset manager to use the assets if the assets are not needed for system supply. Atmos also points to the fact that it can preempt the use of the capacity and storage assets whenever they are needed, while under the management contract for the nuclear facility IES had to give one-year notice to regain control of the asset.

The Board finds that the decision in the March 7, 2007, order is still correct. Even though there are differences between provisions of the nuclear station asset management contract and the Atmos contract, they both fall within the statutory definition as an indirect transfer of assets. Even though Atmos may have the right to use the assets for system customers when they are needed, it has still sold control over those assets for some period of time to a third party. Atmos' arguments concerning the terms of the contract may provide support for the granting of a waiver request, however, they do not remove the contract from the Board's jurisdiction over

reorganizations. An asset management contract whereby a third party contracts to use assets that provide service to ratepayers falls within the statutory definition and provides the Board with the necessary regulatory oversight to protect ratepayer and public interests in those assets. Retention of the Board's oversight authority of these types of contracts under Iowa Code § 476.77 will ensure the contracts are not detrimental to ratepayers.

The arguments made by Atmos about how the contract is used and Atmos' ability to use the assets when needed go to the question of whether the filing requirements should be waived. Those arguments do not change the essential nature of the transaction. The Board finds that its decision in the March 7, 2007, order was correct in applying Iowa Code § 476.77 to the asset management contract and Atmos is required to file a proposal for reorganization unless it meets one of the exemptions in rule 32.2 or is granted a waiver.

The asset management contract for gas purchasing assets is not similar to these activities specifically exempted in 199 IAC 32.2(3). In subrule 32.2(3), the Board could have included natural gas capacity purchases and sales as one of the specific activities exempted, since it included "electric capacity purchases and sales" and "gas purchases" in the list. It is reasonable to interpret the absence of these activities from the list as excluding them from those activities that the Board intended to exempt. By not specifically listing natural gas capacity purchases and sales in the exemptions, the Board intended that purchases and sales of natural gas capacity

should be subject to Board review. The Board reviewed the rulemaking docket in which the exemptions were established and found that the discussion in that docket primarily concerned the question of whether any particular activity was conducted in the ordinary course of business. Since natural gas capacity purchases and sales are not specifically exempted, the focus of the inquiry is whether these activities are part of the ordinary course of business.

Atmos has argued that it has entered into yearly asset management contracts for the gas purchasing assets in Iowa since 2004. These contracts were initially with third parties that were not affiliates and Atmos was not required to file the contract under 199 IAC chapter 31 until the third party was an affiliate. Atmos then argues that these types of third-party arrangements for the management of capacity and storage assets are common in the industry and should be considered as part of the ordinary course of business of a natural gas utility and be exempt from the filing requirements under subrule 32.2(3).

Regardless of the frequency of the use of asset management contracts by Atmos, the Board still considers contracting with a third party for use of those assets to be outside the ordinary course of business of a rate-regulated natural gas utility. In the March 7, 2007, order, the Board stated that it considered the ordinary course of business for rate-regulated natural gas utilities to include purchasing gas as a part of company operations and the retention of control of those assets. The Board stated that asset management contracts with third parties do not lend themselves to the

same regulatory oversight as do other transactions in the ordinary course of business and regulatory oversight must occur before the asset management plan is implemented to ensure ratepayer interests are properly protected.

By not specifically listing natural gas capacity purchases and sales in the exemptions in rule 32.2, the Board determined that those activities were distinct and separate activities from gas purchases and should not be exempt unless it was done in the ordinary course of business. As pointed out in the March 7, 2007, order, the utility as part of the ordinary course of business undertakes natural gas capacity purchases and sales pursuant to regulations of the Federal Energy Regulatory Commission (FERC) and these activities would be the ordinary course of business for a regulated natural gas utility. Entering into a contract with a third party to manage these assets is outside the ordinary course of business and should not be removed from the Board's regulatory oversight.

These types of transactions require regulatory oversight so that the Board can ensure ratepayer interests are protected. Iowa Code § 476.77 allows the Board to waive the filing requirements and to exempt certain filings from the filing requirements when it determines that the review is not necessary in the public interest. These provisions allow the Board to exercise its regulatory oversight and provide sufficient flexibility to prevent unnecessary expenditure of money and resources by the utility where appropriate.

The Board considers its decision in the March 7, 2007, order to be correct and will deny the application for reconsideration. The asset management contract entered into by Atmos is an indirect disposition of a substantial part of Atmos' assets; the contract is the same general type of transaction as the DAEC service agreement; the contract falls within the scope of the reorganization statute; and asset management contracts for natural gas purchasing assets are not exempt under subrule 32.2(3) as being a similar activity to the specific exemptions and these transactions are not part of the ordinary course of business of a rate-regulated natural gas utility.

## **APPLICATION FOR WAIVER**

### **1. Atmos's Position**

In the alternative, Atmos has requested a waiver of the filing requirements of Iowa Code §§ 476.76 and 476.77 if the Board does not grant reconsideration. In support of the waiver request, Atmos addresses the four waiver criteria in 199 IAC 1.3.

Atmos states that application of the reorganization review requirements would pose an undue hardship on Atmos. Transportation, storage, and capacity management contracts like the one at issue have been utilized by Atmos since December 2004. When Atmos Energy Marketing, LLC, became the successful bidder, Atmos began filing the contracts with the Board. The contract has a one-year term and each year Atmos issues a new request for proposal and awards a new

contract to the successful bidder. The reorganization review process takes at least 90 days and if Atmos were required to file a proposal for reorganization each time it wanted to issue a contract to the successful bidder, it would spend half of every contract year in a reorganization proceeding. The time, expense, and administrative burden involved would be enormous and would add additional costs to Board and Consumer Advocate assessments.

Atmos states that waiver of the reorganization review would not prejudice the substantial legal rights of any person. The management contract at issue is on file with the Board as an affiliate contract. Even if the contract were with an unaffiliated third party, the costs and revenues associated with the contract are accounted for through the PGA filing. The Board and interested persons have these other avenues of oversight.

Atmos points out that Iowa Code § 476.77(4) specifically permits the Board to waive the reorganization review requirement if the Board finds the review is not necessary in the public interest. Based upon the presence of the waiver provision in the statute, Atmos suggests that the review is not mandated by statute or any other provision of law.

Substantially equal protection of the public health, safety, and welfare is afforded by means other than the reorganization review process. The Board can review the contract pursuant to Iowa Code § 476.74 and 199 IAC 31.3 and the annual PGA filing under Iowa Code § 476.6(12) and 199 IAC 19.10(2).

Atmos states that it has an obligation to its customers to ensure that it has sufficient gas supply and delivery capacity to meet peak day demands of its firm residential and small commercial customers. All of Atmos' system supply in Iowa is supplied through the interstate pipeline system and Atmos has to subscribe to pipeline and storage capacity sufficient to meet the demand requirements of its firm customers on the peak day. The costs associated with interstate pipeline capacity, transportation, and storage are borne by Atmos's customers as part of the PGA and recovered through the PGA factor. Atmos therefore takes very seriously its obligation to reduce its PGA costs whenever and wherever it can safely and reliably do so. Contracting with an asset manager for these assets allows Atmos to lower its commodity costs.

Atmos mitigates the cost of interstate pipeline capacity and storage in two ways when gas consumption declines. The first is through periodic capacity releases pursuant to FERC capacity release and bidding provisions. This procedure yields small amounts of revenue since the capacity and assets used to serve Atmos' Iowa operations are relatively small. Iowa assets are not geographically proximate to any major urban or industrial market and this also affects the marketability of the Iowa assets.

The second way Atmos mitigates the cost is with the asset management contract. Under that arrangement, the asset manager has the authority to use Atmos' interstate pipeline capacity and storage, subject to Atmos' prior need, and to

retain any revenue derived from interim capacity releases. Gas purchased by Atmos under the contract is at an indexed price, as reported in Inside FERC Gas Market Report.

Atmos states that pipeline costs change very infrequently and the savings from the management contract are index-based, whereas the natural gas market is extremely volatile and prices are constantly changing. Atmos states that prior to the management contract Atmos paid a premium of \$0.005 per Dth. Atmos' planned purchases for November 2006 through October 2007 are 530,000 Dth. The discount for the period November 2005 through October 2006 was \$0.015 per Dth. The current discount for the period November 2006 through October 2007 is \$0.025 per Dth. Using the corrected numbers from the May 16, 2007, filing and assuming the 530,000 Dth purchases were made prior to the management contract, Atmos states that it paid an additional \$2,650 for supply before the asset management contract, compared to \$7,950 less from November 2005 through October 2006 and \$13,250 less from November 2006 through October 2007 under the contract.

Atmos argues that the asset management contract is a responsible way for it to manage its interstate pipeline transportation, storage, and capacity. If Atmos is required to file a proposal for reorganization each time it chooses to award the contract to a successful bidder, it would spend half of every year in a reorganization proceeding and a couple of months preparing to file the proposal for reorganization. Furthermore, the Board and Consumer Advocate would be administratively burdened

by the filings. Other procedures exist that allow the Board and Consumer Advocate regulatory oversight of both the contract itself and the costs and revenues associated with the contract. For these reasons, Atmos contends the reorganization review requirement is not necessary in the public interest.

## **2. Consumer Advocate's Position**

In the April 18, 2007, response, Consumer Advocate indicates that it does not object to the application for waiver for certain of the reasons stated by Atmos and its January 19, 2007, response.

Consumer Advocate states that it endorses the goal of reducing gas costs for customers. Consumer Advocate points out that Atmos must take all reasonable actions to minimize its purchase gas costs while ensuring adequate long-term supply of natural gas and operate in an efficient manner. Consumer Advocate indicates that it has reviewed the procurement and execution of the asset management plan and has no objections to the agreement as it has been implemented.

## **3. Board Discussion**

Pursuant to Iowa Code § 476.77(4), the Board may waive the filing requirements of § 476.77 if the Board finds a review of the reorganization is not necessary in the public interest. The statutory waiver is reflected in Board rules at 199 IAC 32.8. In rule 199 IAC 1.3 the Board has adopted four criteria for considering a waiver request; while these criteria are not directly applicable to a § 476.77 waiver request, they provide a useful framework for analysis. The four criteria are: 1) the

application of the rule would pose an undue hardship on the requesting party; 2) the waiver would not prejudice the substantial rights of any person; 3) the provisions of the rule are not specifically mandated by statute or another provision of law; and 4) substantially equal protection of public health, safety, and welfare will be afforded by a means other than that prescribed in the rule. Atmos has addressed the four criteria in its waiver request.

The Board finds that it would be an undue hardship on Atmos to be required to file a proposal for reorganization each year in anticipation of entering into an asset management contract for its natural gas purchasing assets. The time and annual expense of such a filing would outweigh the benefits that could be derived from a review of the yearly asset management contracts under the provisions of Iowa Code § 476.77. The Board has other regulatory oversight procedures, now that it is aware of the existence of these contracts that will provide the Board with the opportunity to examine the contracts and the effect they have on ratepayers.

The Board finds that waiver of the reorganization review would not prejudice the substantial legal rights of any person and the provisions of the rule subject to the waiver request are not specifically mandated by statute or another provision of law. Iowa Code § 476.77 establishes the requirement for a review of proposals for reorganization, however, the statute also provides for a waiver of that review. Granting a waiver would therefore not prejudice the legal rights granted by the statute since the waiver is provided for in the statute.

The Board finds that substantially equal protection of the public health, safety, and welfare is afforded by means other than the reorganization review process. If the contract is with an affiliate, the Board can review it pursuant to Iowa Code § 476.74 and 199 IAC 31.3 and the Board can review the costs and revenues associated with the contract in the annual PGA reconciliation filing under Iowa Code § 476.6(12) and 199 IAC 19.10(2). To ensure that the Board has the necessary information about the contract, regardless of whether it is with an affiliate or some other third party, the Board will require Atmos to file a copy of the contract each year with the annual PGA reconciliation filing and include information showing the benefits and costs associated with the contract. This will allow the Board an opportunity to review the contract on a yearly basis without the necessity of a reorganization filing.

As discussed above, the Board does not believe review of the asset management contract each year in a reorganization filing is necessary in the public interest. Consumer Advocate conducted discovery concerning the asset management contract and stated it had no objections to the contract. Atmos has chosen to enter into these contracts as a way to meet its obligations to its ratepayers at the lowest reasonable cost. The Board can provide the necessary regulatory oversight of these transactions without requiring a proposal for reorganization each year the asset management contract is executed. The major concern is that the contracts were entered into without contacting the Board or making a filing to determine if they came within the definition of a reorganization under Iowa Code

§ 476.76 in the first place. Other public utilities that have considered entering into asset management contracts have contacted the Board in advance to discuss with the Board whether the transaction might fall within the purview of the reorganization statute. The Board is required by statute to review transactions that might detrimentally affect the service provided by a rate-regulated utility to customers.

Based upon consideration of the four criteria in 199 IAC 1.3 and the public interest in general, the Board will grant the request to waive the filing requirements. Board review of the asset management contract for natural gas capacity under Iowa Code § 476.77 is not necessary in the public interest. As indicated above, the Board can exercise its regulatory oversight of these contracts through the annual PGA reconciliation filing. As a condition of granting the waiver, the Board will require Atmos to file a copy of the contract and updated information showing the cost and benefits associated with the contract with each annual PGA reconciliation filing regardless of whether the asset manager is an affiliate. The Board will then be able to consider how the asset management contract is affecting the price of gas Atmos charges customers.

### **ORDERING CLAUSES**

#### **IT IS THEREFORE ORDERED:**

1. The application for reconsideration filed by Atmos Energy Corporation on April 13, 2007, is denied.

2. The application for waiver filed by Atmos Energy Corporation on April 13, 2007, is granted.

3. Atmos Energy Corporation shall file with each annual purchased gas adjustment reconciliation a copy of any asset management contract entered into for the management of gas purchasing assets and calculations showing the costs and benefits derived from that contract.

**UTILITIES BOARD**

/s/ John R. Norris

/s/ Curtis W. Stamp

ATTEST:

/s/ Judi K. Cooper  
Executive Secretary

/s/ Krista K. Tanner

Dated at Des Moines, Iowa, this 28<sup>th</sup> day of June, 2007.