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MEMORANDUM

TO: Allied Coalition of Cities

FROM: Betsy Todd and Geoffrey Gay

DATE: December 9, 2004

RE: Atmos Gas Costs Prudence Review; GUD No. 9530

Many of you have recently received notice from Atmos Energy Corporation (formerly TXU Gas Company) of the filing at the Railroad Commission of a three-year gas cost prudence review. This filing is one in a series of triennial filings required by the Commission as part of the Final Order in Gas Utilities Docket (GUD) No. 8664, TXU's city gate gas rate case decided in 1997. The purpose of the filing requirement is to allow a periodic review of the prudence of TXU's gas purchases. TXU's Gas Cost Review documentation as to its purchasing practices, as well as the actual amount and cost of gas purchases for the period of November 1, 2000, to October 31, 2003, was filed at the Commission on September 24, 2004, and was assigned GUD No. 9530. The sale of TXU's gas utility operations to Atmos was completed on October 1, 2004, and notice to customers of the filing of GUD No. 9530 was approved on November 5, 2004. The hearings examiner assigned to the docket ordered Atmos to begin mailing notices to all cities served by the former TXU Gas Distribution-Transmission by November 9, 2004. A copy of the notice is attached for reference.

We have reviewed the documentation filed by the Company and it indicates that TXU purchased 1.93 Bcf of gas during the three year period covered by the review at a total cost of \$2.2 billion. This is twice the cost of gas purchases included in TXU's filing for the previous three-year period. This is despite the fact that one of the representations made by TXU to settle the last prudence review was that it had renegotiated a gas purchase contract for an expected benefit to ratepayers of over \$20 million. For this filing, monthly average costs per MMBTU ranged from \$2.34 to \$8.17, with the average cost being \$4.67. Testimony included in the filing indicates that TXU only sought to lock in prices for 35-40 percent of the gas needed to meet its anticipated winter demand during this three year period. Over half of all of the gas purchases were made on the spot market. If these or other purchases are found to be imprudent by the Commission, Atmos will be ordered to pay refunds to all of its customers.

When TXU made its last three-year prudence review filing (GUD No. 9233), many of the same cities who participated in GUD No. 9400 intervened in that docket jointly and were ultimately successful in achieving a settlement of all issues with TXU. The cities' expenses were

handled in the same manner as in other rate cases: TXU reimbursed the cities' expenses and they were ultimately surcharged to customers. The savings achieved as a result of the settlement of that docket greatly exceeded the cities' costs surcharged to customers.

We made an effort recently to negotiate a resolution of the gas prudence docket, as well as other outstanding regulatory issues (e.g. rate case expenses from GUD No. 9400) with Atmos. Since Atmos rejected that settlement offer, it is appropriate that Cities intervene in Gas Utilities Docket No. 9530 to evaluate the possibility of refunds attributable to excessive gas cost purchases.

Attached is a form resolution to be used to authorize intervention by interested cities. Please forward any adopted resolutions as soon as possible so that interventions can be filed with the Commission. The examiners have established a December 10, 2004, deadline; however, later interventions can be filed as long as they do not cause further delay. We have filed an intervention on behalf of the Steering Committee and the City of Arlington. Interventions for other individual cities should be filed as soon as possible.

Please contact us if you have any questions about this docket or city participation.

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