

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF ATMOS ENERGY) CASE NO.
CORPORATION FOR PRP RIDER RATES) 2020-00229

ORDER

On July 27, 2020, Atmos Energy Corporation (Atmos) filed with the Commission its annual application to establish Pipeline Replacement Program (PRP) Rider rates for the 12 months beginning October 1, 2020. Atmos responded to one request for information from Commission Staff. There are no intervenors in this proceeding. The case now stands submitted for a decision.

Atmos forecasts that it will spend approximately \$26,691,466 on bare steel pipeline replacement from October 2020 through September 2021.¹ This proposal complies with the annual ratepayer-funded PRP investment cap of \$28,000,000 for bare steel pipeline replacement as ordered in Case No. 2018-00281.² Atmos proposes a revenue requirement for the 12 months beginning October 1, 2020, of \$5,961,006 to recover PRP

¹ Application, Exhibit C.

² Case No. 2018-00281, *Electronic Application of Atmos Energy Corporation for an Adjustment of Rates* (Ky. PSC May 7, 2019), final Order at 15–16.

additions from October 1, 2019, to September 30, 2021.³ Atmos's proposed PRP rate base is \$54,296,127.⁴

DISCUSSION

Revenue Requirement

To calculate its PRP rate base in this matter, Atmos used net plant based on the total PRP additions and retirements for the entire two years ending September 30, 2021, which is the ending balance of its gross PRP plant as of that date. Atmos calculated its accumulated depreciation on PRP plant additions using the half-year convention for the forecasted period,⁵ which assumes plant additions will be added evenly throughout the forecasted period. Similarly, Atmos calculated the monthly changes to its Accumulated Deferred Income Taxes (ADIT) in the forecasted period based on the assumption that the net PRP plant additions in the forecasted period would be spread evenly throughout the year, and it calculated the effect of those monthly changes on rate base during the forecasted period using the pro rata method,⁶ which is required by federal law but approximates a 13-month average calculation.⁷ Thus, Atmos's use of its forecasted

³ Application, Exhibits B and I. See also Atmos's Response to Commission Staff's First Request for Information (Response to Staff's First Request) (filed Sept. 14, 2020), Item 4, Attachment 1, Exhibits B and I.

⁴ Application, Exhibits B and I. See also Response to Staff's First Request, Item 4, Attachment 1, Exhibits B and I.

⁵ Application, Exhibits B, C, and D.

⁶ Response to Staff's First Request, Items 1(b) and 4, Attachment 1, Exhibit F.

⁷ See I.R.S. Priv. Ltr. Rul. 201717008, 2017 WL 1535818 (Jan. 25, 2017) (released Apr. 28, 2017) ("In regard to Taxpayer's requested ruling two, we agree with Taxpayer that averaging conventions, when applied to entirely future test periods, should presumptively be treated as having the same purpose as the Proration Requirement, thereby negating the necessity to apply both conventions serially to changes in [ADIT] balances."); see also *In Re Midcontinent Independent System Operator, Inc., et al.*, 163 FERC ¶ 61061, 2018 WL 2017529 (FERC Dec. 20, 2018) (recognizing that the IRS found that the proration methodology required by normalization is a form of averaging when applied to a forecasted test period such

ending balance of gross plant is inconsistent with the methods it used to calculate every other aspect of PRP rate base.

Using the ending balance to reflect the net plant increases arising from PRP additions and retirements during the forecasted period also means that, on average, Atmos will collect a return on investments it has not yet made.⁸ It is also inconsistent with the manner in which Atmos's rate base is calculated when its base rates are established using a forecasted test year and with 807 KAR 5:001, Section 16(6)(c), which requires utilities requesting a general rate adjustment based on a forecasted test year to calculate their rate bases using a 13-month average.

Atmos argues that the PRP rider rates are calculated in a manner consistent with its prior filings and that its PRP tariff requires it to use the ending net plant balances.⁹ Atmos further asserts that monthly forecasted plant additions and retirements are not "readily available" and requests that any changes to the PRP calculation be made in a future base rates case.¹⁰

The relevant part of Atmos's PRP tariff states:

The filing will reflect the anticipated impact on the Company's revenue requirements of net plant additions related to bare-steel pipe replacement as offset by operations and maintenance expense reductions during the upcoming fiscal year ending each September as well as a balancing adjustment to reconcile collections with actual investment for the preceding program year.¹¹

using the pro rata method to calculate ADIT changes in a forecasted test period is consistent with using a 13-month average of other rate base items).

⁸ Response to Staff's First Request, Item 1.

⁹ Response to Staff's First Request, Items 1 and 4, Attachment 1, Schedule F.

¹⁰ Response to Staff's First Request, Item 4.

¹¹ PSC KY No. 2, Second Revised Sheet No. 38.

This language does not support Atmos's assertions that it is precluded from utilizing a 13-month average net investment rate base. Atmos appears to confuse a fiscal year ending each September with an ending balance as of each September. Further, by the very nature of Atmos's PRP Rider, its PRP rates are in addition to its base rates, and there is no dispute that allowing Atmos to use the ending balance would, on average, allow Atmos to recover for investments it has not made. Thus, the Commission finds no reason to continue with an erroneous methodology until Atmos's next base rate case and that it would be unreasonable to do so.

In fact, Atmos has argued in a previous rate case that it is unlawful to use inconsistent estimates and projections to calculate rate base, ADIT, depreciation, and tax expense.¹² Yet, Atmos proposes to calculate the effect of its substantial gross additions to plant by essentially assuming that all of the additions will have been made on the first day of the forecasted period while it simultaneously assumes that those same gross additions will be made over the course of a year to calculate the ADIT offset they generate. If an intervenor were to suggest that the Commission amplify the effect of an ADIT offset by assuming that it was generated on the first day of a forecasted test period while simultaneously assuming that plant additions occurred over a year, Atmos would presumably raise objections alleging violations of the federal consistency rule, and the

¹² See Case No. 2017-00349, *Electronic Application of Atmos Energy Corporation for an Adjustment of Rates and Tariff Modifications* (Ky. PSC May 3, 2018), Rebuttal Testimony of Jennifer K. Story at 39-40; see also 26 U.S.C.A. § 168(i)(9)(B)(ii) (stating that a normalization method of accounting prohibits the use of "any procedure or adjustment for ratemaking purposes which uses an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under subparagraph (A)(ii) unless such estimate or projection is also used, for ratemaking purposes, with respect to the other 2 such items and with respect to the rate base").

Commission has accepted such objections in the past. Thus, again, the Commission finds that it would be unreasonable to allow Atmos's inconsistent treatment to continue.

Using the information Atmos has already submitted, the Commission has calculated the PRP rate base using the 13-month average of gross plant during the forecasted period. To calculate the 13-month average rate base, the Commission assumed that Atmos's PRP plant additions and retirements would occur evenly throughout the forecasted period. Calculating the 13-month average rate base for the forecasted period based on equal monthly additions during the forecasted period simply puts all rate base components on a similar basis given Atmos's use of equal monthly additions to calculate ADIT and the half year convention to calculate accumulated depreciation for forecasted additions. Further, because Atmos was either unable or unwilling to calculate rate base using a 13-month average based on actual monthly projections, the Commission finds that spreading plant additions and retirements evenly throughout the forecasted period, as Atmos did to calculate rate base offsets, is the only reasonable method supported by the record to calculate a 13-month average rate base.

The Commission also identified an error in Atmos's rate base calculation related to the ADIT offset. Specifically, in its recent base rate case and in this matter, Atmos has calculated the effect of its income on its net operating loss (NOL) carryforwards in forecasted periods by comparing the ADIT generated against its projected tax expense in a forecasted period.¹³ If the ADIT generated exceeds its projected tax expense, then Atmos has recorded a corresponding increase in deferred tax assets related to NOL carryforwards in the forecasted period, which increases its rate base. Conversely, if the

¹³ Case No. 2018-00281, *Atmos Energy Corporation* (Ky. PSC May 7, 2019), Application, Schedule B-5 F.

tax expense exceeds the ADIT generated, then Atmos has recorded a reduction in its deferred tax assets and a corresponding decrease in its rate base to recognize that NOL carryforwards would be used to reduce that tax expense and, therefore, would increase its net ADIT.

In its application, Atmos estimated the effect of its income on its NOL position as discussed above except that it compared the ADIT generated in the previous year and the ADIT generated in the forecasted period against its projected tax expense in only the forecasted period. Based on that comparison, Atmos determined that the ADIT generated exceeded the tax expense such that an NOL carryforward was created for the difference. The problem with Atmos's methodology was that only the ADIT generated in the forecasted period should be compared against the projected tax expense in the forecasted period to determine changes in Atmos's NOL position during the forecasted period.

Atmos acknowledged this error and corrected it.¹⁴ To do so, Atmos compared the pro rata calculation of the ADIT generated in the forecasted period, \$(620,075), with the projected tax expense in the same period, \$1,011,330, and determined that the ADIT in the forecasted period should be increased by its NOL carryforwards, which would be reduced by \$(391,255) such that the total ADIT change in the forecasted period should be \$(1,011,330).¹⁵ Atmos then recalculated its rates using \$(1,011,330) as the total ADIT

¹⁴ Response to Staff's First Request, Item 2.

¹⁵ The Commission notes that using a 13-month average rate base will affect Atmos's income as discussed below and therefore its income tax expenses. The change in income tax expense will, in turn, affect the ADIT change in the forecasted period. However, the Commission used Atmos's methodology and simply included the new tax expenses to calculate the ADIT generated in the forecasted period.

offset.¹⁶ However, in doing so, Atmos did not include in its rate base the ADIT that was generated from timing differences in the year ending September 30, 2020.

ADIT is cumulative and the Commission has always required that ADIT generated in previous years be included as an offset to rate base until the timing differences that generated that ADIT have fully reversed.¹⁷ Further, ADIT calculated for historical periods is based on the ending balance of the ADIT in the same way the Commission uses the ending balance for plant and other rate base items for historical periods. Thus, the ADIT offset for PRP plant in this matter should include Atmos's ADIT as of September 30, 2020, in the amount of \$(1,175,016), as well as any change in the ADIT during the forecasted period.¹⁸

With the adjustments discussed above, the Commission finds that Atmos's PRP rate base is \$39,368,373 and its PRP revenue requirement is \$4,474,439 as shown in Appendix A. The Commission further finds that Atmos should include language in its tariff indicating that Atmos's PRP rate base in any forecasted period will be calculated in a manner consistent with 807 KAR 5:001, Section 16(6)(c).

Rate Design

Pursuant to Atmos's PRP Rider tariff, the rate class allocation of the PRP revenue requirement will be in proportion to the relative base revenue share approved in Atmos's

¹⁶ Response to Staff's First Request, Item 4, Attachment 1, Exhibit B, line 12.

¹⁷ See Case No. 2018-00281, *Atmos Energy Corporation* (Ky. PSC May 7, 2019), Application, Schedule B-5 B.

¹⁸ $\$(4,121,980) \times 24.95\% = \$(1,028,434)$
 $\$(587,504) \times 24.95\% = \underline{\$(146,582)}$
 $\$(1,175,106)$

most recently concluded base rate case.¹⁹ While Atmos appropriately used the billing determinants from Case No. 2018-00281, it did not use the rates approved therein.²⁰ Atmos corrected this error, which affected the allocation of the PRP revenue requirement and the resulting rates.²¹

Tariff Changes

Consistent with its tariff, Atmos proposes to use the rate of return, including return on equity (ROE) of 9.65 percent, established in its last rate case. The Commission has not previously set forth a requirement to establish a reasonable ROE each time Atmos files a PRP rate application. However, the Commission finds that no public purpose is served by the continuation of a previously approved ROE without regard to the reasonableness of the rate. Therefore, the Commission finds that Atmos should revise its tariff language to reflect that the overall rate of return will be established in the annual PRP rate application. Given the condensed processing timeline of these proceedings, the Commission strongly recommends that Atmos file adequate testimony to support its proposed rate of return, including a reasonable ROE.

Atmos's PRP Tariff states that "a balancing adjustment to reconcile collections with actual investment for the preceding program year" will be included in Atmos's PRP Rider

¹⁹ PSC KY No. 2, Second Revised Sheet No. 38.

²⁰ Application, Exhibit I and Case No. 2018-00281, Direct Testimony of Josh C. Densman, Exhibit JCD-1 and final Order, Appendix B. See also Case No. 2018-00253, *Electronic Application of Atmos Energy Corporation for PRP Rider Rates* (Ky. PSC Sept. 24, 2019), Application, Exhibit I. Atmos appropriately used the billing determinants from 2018-00281, but it did not use the rates approved therein. This error will be corrected when Atmos files its 2022 PRP application.

²¹ Response to Staff's First Request, Items 3 and 4.

rates;²² however, Atmos's balancing adjustment is actually filed with a two-year lag due to the timing of the annual filings. The Commission finds that Atmos should revise its tariff language to reflect the actual timing of the balancing adjustment.

CONCLUSION

Having reviewed the evidence of record and being otherwise sufficiently advised, the Commission finds that the information contained in Atmos's application and its responses to discovery requests are in sufficient detail to support the reasonableness of the attached PRP Rider rates.

IT IS HEREBY ORDERED that:

1. The PRP rates proposed by Atmos are denied.
2. The PRP rates in the Appendix B to this Order are approved for service rendered by Atmos on and after October 1, 2020.
3. Within 20 days of the date of entry of this Order, Atmos shall file with this Commission, using the Commission's electronic Tariff Filing System, revised tariff sheets setting out the rates approved herein and reflecting that they were approved pursuant to this Order.
4. Within 20 days of the date of entry of this Order, Atmos shall file with this Commission, using the Commission's electronic Tariff Filing System, revised tariff sheets to include language (1) indicating that Atmos's PRP rate base in any forecasted period will be calculated in a manner consistent with 807 KAR 5:001, Section 16(6)(c); (2)

²² Response to Staff's First Request, Item 1(a), Attachment 1, and PSC KY No. 2, Second Revised Sheet No. 38.

reflecting that the overall rate of return will be established in the annual PRP rate application; and (3) reflecting the actual timing of the balancing adjustment.

5. This case is closed and removed from the Commission's docket.

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By the Commission



ATTEST:



Acting Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2020-00229 DATED SEP 30 2020

Atmos Energy Corporation
Pipeline Replacement Program Rider
October 2020 - Septmeber 2021

Line Number	Description	Total	Atmos's response to Staff's First Request, Item 4	Difference
1	Project Additions	\$ 39,996,032	\$ 53,341,765	\$ (13,345,733)
2	Project Retirements	(9,137,846)	(12,442,869)	3,305,023
3	Gross Plant	<u>\$ 30,858,185</u>	<u>\$ 40,898,895</u>	<u>\$ (10,040,710)</u>
4				
5	Cost of Removal to Accumulated Depr.	\$ 2,014,401	\$ 2,677,567	\$ (663,165)
6	Retirements from Accumulated Depr.	9,137,846	12,442,869	(3,305,023)
7	Depreciation Accrual to Accumulated Depr.	(711,874)	(711,874)	-
8	Accumulated Depreciation	<u>10,440,374</u>	<u>14,408,562</u>	<u>(3,968,188)</u>
9				
10	Net Plant	<u>\$ 41,298,559</u>	<u>\$ 55,307,457</u>	<u>\$ (14,008,899)</u>
11				
12	Accumulated Deferred Income Taxes	(1,930,185)	(1,011,330)	(918,855)
13	Rate Base	<u>\$ 39,368,373</u>	<u>\$ 54,296,127</u>	<u>\$ (14,927,754)</u>
14				
15	Rate of Return	7.49%	7.49%	0.00%
16	Required Operating Income	<u>\$ 2,948,541</u>	<u>\$ 4,066,573</u>	<u>\$ (1,118,032)</u>
17				
18	Depreciation & Amortization Expense	533,873	533,873	0
19	O&M Savings	(18,695)	(18,695)	0
20	Ad Valorem Tax Increase	246,116	326,198	(80,082)
21	Income Taxes on Cost of Service Items	(189,943)	(209,923)	19,980
22	Income Taxes on Adjusted Interest Expense	(185,332)	(255,606)	70,274
23	Operating Income at Present Rates	<u>\$ 386,019</u>	<u>\$ 375,846</u>	<u>\$ 10,173</u>
24				
25	Deficiency	\$ 3,334,560	\$ 4,442,419	\$ (1,107,859)
26	Tax Factor	74.52%	74.52%	0.00%
27	Total Rate Adjustment	<u>\$ 4,474,439</u>	<u>\$ 5,961,006</u>	<u>\$ (1,486,567)</u>
28				
29	Total Rate Adjustment	<u>\$ 4,474,439</u>	<u>\$ 5,961,006</u>	<u>\$ (1,486,567)</u>

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2020-00229 DATED SEP 30 2020

The following rates and charges are prescribed for the customers in the area served by Atmos Energy Corporation. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under the authority of the Commission prior to the effective date of this Order.

Pipe Replacement Program Rider Rates

	<u>Monthly Customer Charge</u>		<u>Distribution Charge per Mcf</u>
Rate G-1 (Residential)	\$ 1.38		\$0.0000
Rate G-1 (Non-Residential)	\$ 4.50		\$0.0000
Rate G-2	\$20.56	1-15,000 Mcf	\$0.0239
		Over 15,000 Mcf	\$0.0183
Rate T-3	\$22.97	1-15,000 Mcf	\$0.0433
		Over 15,000 Mcf	\$0.0332
Rate T-4	\$23.20	1-300 Mcf	\$0.0653
		301-15,000 Mcf	\$0.0452
		Over 15,000 Mcf	\$0.0361

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