COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF ATMOS ENERGY CORPORATION FOR PRP RIDER RATES BEGINNING OCTOBER 1, 2023	)))	CASE NO. 2023-00231

O R D E R

On July 31, 2023, Atmos Energy Corporation (Atmos Energy) filed an application with the Kentucky Public Service Commission (Commission) for approval to establish Rider Rates for its Pipeline Replacement Program (PRP) for the 12-month period beginning October 1, 2023. There are no intervenors in this case. The matter now stands submitted for a decision.

LEGAL STANDARD

KRS 278.030(1) states that "[e]very utility may demand, collect and receive fair, just and reasonable rates" for utility service. Pursuant to KRS 278.509, the Commission may allow a utility to recover costs for investment in natural gas pipeline replacement programs that are not recovered in existing rates through a rider if the costs are fair, just and reasonable. The burden of proof to show that an increased rate or charge is just and reasonable shall be upon the utility.[1]

[1] KRS 278.190(3).

FINDINGS AND DISCUSSION

Revenue Requirement

Return On Equity – Atmos calculated its PRP revenue requirement based on a 9.45 percent return on equity (ROE) as it was authorized to do in Case No. 2022-00222.[2] The Commission finds that Atmos's use of that ROE in this case is reasonable and should be approved. Further, while Atmos may file ROE testimony in its next PRP case in its discretion, the Commission finds, for the same reasons discussed in Case No. 2022-00222,[3] that it would be reasonable for Atmos to use the PRP ROE approved herein in its next PRP filing, and therefore, finds that Atmos may rely on the PRP ROE approved herein in its next PRP filing without filing ROE testimony.

Net Operating Loss Accumulated Deferred Income Taxes – In Atmos's most recent rate case,[4] in which its PRP rate was rolled into base rates and reset to zero, the Attorney General's witness argued that Atmos's net operating loss position was reversing in the forecasted test period, so it was no longer reasonable to assume that the PRP rider will generate incremental deferred tax assets from net operating loss carryforwards (NOL ADIT) to completely offset incremental deferred tax liabilities (ADIT liability) arising from its accelerated tax expensing of pipeline replacement projects. The Commission agreed, in part, with the Attorney General's position and stated:

> [C]onsistent with the Commission's determination above that the generation and utilization of NOL ADIT included in rate base for Kentucky should be based on Kentucky operations,

[2] Case No. 2022-00222, *Electronic Application of Atmos Energy Corporation to Establish PRP Rider Rates for the Twelve Month Period Beginning October 1, 2022* (Ky. PSC May 25, 2023), Order at 24.

[3] *See* Case No. 2022-00222, May 25, 2023 Order at 24-25.

[4] Case No. 2021-00214, *Electronic Application of Atmos Energy Corporation for an Adjustment of Rates* (Ky. PSC May 19, 2022), Order at 61.

> the PRP calculation should only reflect an incremental increase in NOL ADIT if Atmos Kentucky is able to establish that its Kentucky operations and its PRP spend actually generated NOL ADIT during the relevant period. The Commission will not accept the imputation of NOL ADIT where none was generated by Kentucky operations in the PRP period, because it would be inconsistent with ratemaking principles and federal normalization rules.[5]

In Case No. 2022-00222, Atmos's first PRP case following its rate case, Atmos projected that ADIT liability in the amount of $(3,805,097) would arise from its accelerated tax expensing of pipeline replacement projects in the PRP program year—Atmos's 2023 fiscal year, which runs October 1, 2022 through September 30, 2023. However, Atmos also estimated that NOL ADIT in the amount of $3,502,155 would arise from net operating losses in the PRP program year, and Atmos included that NOL ADIT in rate base for its PRP revenue requirement model as an offset to the ADIT liability.[6] Atmos estimated its NOL ADIT by comparing the projected change in ADIT liability, $(3,805,097), from PRP investments to the projected book tax expense, $317,361, from PRP rates during the program year. The effect, as proposed, was that Atmos's net plant in service was only offset by net ADIT liability of $(317,361) as opposed to the full prorated ADIT liability balance of $(1,954,463) that arose from accelerated tax expensing.[7]

The Commission found that Atmos's method for projecting NOL ADIT in Case No. 2022-00222 did not provide an estimate for NOL ADIT that is reasonably connected to the actual NOL ADIT that would be generated, because Atmos's method imputed the

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[5] Case No. 2021-00214, May 19, 2022 Order at 62.

[6] *See* Application, Exhibit B-1, Exhibit F.

[7] Case No. 2022-00222, *Electronic Application of Atmos Energy Corporation to Establish PRP Rider Rates for the Twelve Month Period Beginning October 1, 2022* (Ky. PSC May 25, 2023), Order at 4.

existence of NOL ADIT in the PRP program year by comparing a significant portion of the ADIT liability that will arise in the program year from Kentucky operations to tax expense on a small fraction of the taxable income from Kentucky operations.[8] The Commission also explained why the broader information Atmos provided in response to requests for information regarding the standalone tax position for Atmos's Kentucky operations failed to establish that its Kentucky operations were in a net operating loss position in the PRP period such that NOL ADIT would arise during the PRP period.[9] Thus, the Commission found that Atmos failed to establish that including its projected NOL ADIT in rate base in that matter was reasonable, and indicated, as it did in Case No. 2021-00214, that the Commission will not include NOL ADIT in future PRP rate base absent specific, credible evidence that Atmos's Kentucky operations and its PRP spend actually generated NOL ADIT during the relevant period or that normalization rules would require it.[10]

In this case, Atmos again imputed the accumulation of NOL ADIT by comparing the ADIT liability that arose from PRP investments to its projected tax expense from PRP rates for its 2024 fiscal year—October 1, 2023 through September 30, 2024.[11] Specifically, Atmos first projected that ADIT liability in the amount of $(3,805,097) and $(2,628,555) arose in its 2023 and 2024 fiscal years, respectively, from timing differences associated with PRP investments. Atmos then estimated its tax expense from PRP rates for its 2024 fiscal year, $787,709, and projected that no ADIT liability that arose from 2023

[8] Case No. 2022-00222, May 25, 2023 Order at 5-6.

[9] Case No. 2022-00222, May 25, 2023 Order at 6-11.

[10] Case No. 2022-00222, May 25, 2023 Order at 11-12.

[11] *See* Application, Exhibit B, Line 12; Application, Exhibit F, Lines 44-59.

or 2024 could have been used to offset tax expense other than the tax expense Atmos projected would arise from its PRP rate in its 2024 fiscal year.[12] Atmos made no attempt to project tax expense or its actual net operating loss position from Kentucky operations in its 2023 or 2024 fiscal years, despite having significant revenue from other rates.[13] Atmos's methodology resulted in it including ADIT liability of $(787,709) to offset net plant in service based on the assumption that the $(6,433,653) ADIT liability balance that arose as of the end of its 2024 fiscal year was otherwise completely offset by NOL ADIT, because it could not be used to offset tax expense.[14]

As the Commission explained in Case No. 2022-00222, Atmos's method of projecting NOL ADIT is unreasonable for a PRP rider, because it produces an NOL ADIT

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[12] Application, Exhibit F, Line 10, 25, and 29 (showing the ADIT liability as of the end of the 2022 PRP program year as $(3,805,097), consistent with the findings in the previous case, though the months appear to be mislabeled); Application, Exhibit F, Line 10, 25, and 56 (showing the cumulative ADIT liability as of the end of its 2024 fiscal year).

[13] *See* Case No. 2021-00214, May 19, 2022 Order (discussing base rates); Case No. 2022-00222, May 25, 2023 Order at 6-7 (noting that Atmos's "Pre Tax Book Income" from the PRP rate in fiscal year 2023 would only be $1,271,987 whereas Atmos's "Pre Tax Book Income" from base rates was expected to be $39,038,257 in the year ended December 31, 2022); Case 2020-00289, *Electronic Request of Atmos Energy Corporation for Modification and Extension of its Gas Cost Adjustment Performance Based Ratemaking Mechanism* (Ky. PSC June 20, 2022), Order (noting that there was $28,267,062 in PBR savings that were shared, in part, with Atmos through its performance based rate from 2017 to 2020 and indicating that those amounts are in addition to its gas costs and provide an incentive, i.e. additional income, beyond its earnings from base rates to encourage Atmos to save on gas costs).

[14] *See* Application, Exhibit B, Line 12; Application, Exhibit F, Lines 44-59.

estimate that is not reasonably connected to Atmos's actual net operating position.[15] In fact, in *Missouri-American Water Company v. Public Service Commission of Missouri*,[16] the Missouri Court of Appeals affirmed an order rejecting a similar method used by Missouri-American Water Company in its pipeline replacement rider, in part, for that reason, stating that the method for imputing NOL ADIT, which in that case consisted of comparing incremental accelerated tax expenses to no pipeline replacement revenue in the first year,[17] "does not show whether the utility is actually generating a net operating loss associated with that investment." Because Atmos's failed to establish that its Kentucky operations were in a net operating loss position in the relevant periods, and therefore, that its accelerated tax expensing of PRP investments could not be used to offset tax expense, the Commission finds that Atmos failed to establish that NOL ADIT was or would be generated from its Kentucky operations during the relevant PRP program years.

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[15] The bulk of the ADIT liability that Atmos projected would be generated during the PRP program year, $(6,163,495), was projected to arise from book-tax differences in the original cost, or basis, of pipeline projects arising from repair deductions, which indicates that a significant portion of the change in ADIT in a given period is tied to the timing of plant additions. *See* Application, Exhibit F, Lines 1-10 (reflecting the connection between ADIT liability and plant additions in the relevant period); Application, Exhibit F-1, Lines 2-22 (reflecting the differences in the original book and tax bases and showing that they are due to expensing of repairs). As in Case No. 2022-00222, Atmos's projected PRP plant additions reflect a significant portion of its total plant additions in previous years, but based on the test period for its most recent rate case, the income and tax expense it is using to impute NOL ADIT represents only a fraction of its total income and tax expense from Kentucky operations. *See* Application, Exhibit B (reflecting PRP operating income of $3,191,000 for the 2023 PRP program year); see also Case No. 2022-00222, May 25, 2023 Order at 6-7 (noting that Atmos's projected PRP spending was about 50 percent of its capital spending in the 3 previous years but that its "Pre Tax Book Income" from the PRP in the 2022 PRP program year was only $1,271,987 whereas Atmos's "Pre Tax Book Income" from base rates was $39,038,257 in the year ended December 31, 2022).

[16] *Missouri-American Water Company v. Public Service Commission of Missouri,* 591 S.W.3d 465, 477 (Mo. App. 2019).

[17] There was no pipeline replacement revenue in that case because it was the first year of the rider after a base rate case and it appears the rider was based on a historical period such that no rider revenue had accrued. *Missouri-American Water Company*, 591 S.W.3d at 470-477. The difference here is that Atmos has very slight incremental PRP income, because its rate is based on a single forecasted year.

Although it failed to establish that NOL ADIT would be generated from its Kentucky operations, Atmos argued that its method for calculating NOL ADIT is required by normalization rules.[18] Specifically, Atmos stated, among other things, that:

> Based on Internal Revenue Code ("IRC") section 168(f)(2), 168(i)(9) and 1.167(l)-1, decreasing taxpayer's rate base by the full amount of its ADIT account balance without reducing it by the taxpayer's NOLC-related account balance would be a violation of the normalization rules. . . Accelerated tax depreciation is subject to the IRC normalization provisions. . . Cumulative NOLC [net operating loss carryforward] which is the result of accelerated depreciation is likewise subject to normalization rules. . . Determination of NOLC attributable to accelerated depreciation must be determined using a last dollar deducted methodology.[19]

However, there is nothing in the normalization rules that requires a state commission to include offsetting NOL ADIT in a case in which a utility has failed to establish that the NOL ADIT would be generated. Thus, Atmos's reliance on the normalization rules would not require the Commission to include its projected NOL ADIT.

Atmos's explanation of how the normalization rules would apply to its ADIT was also materially incomplete. The bulk of the ADIT liability that Atmos projected would be generated during its 2023 and 2024 fiscal years was booked in account FXA01 and represents book-tax differences in the original cost, or basis, of pipeline replacement projects arising from repair deductions made for tax but not book purposes.[20]

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[18] Application, Direct Testimony of Joel J. Multer (Multer Testimony) at page 6.

[19] Multer Testimony at 6-10.

[20] *See* Application, Exhibit F, Lines 1-10 (reflecting the connection between ADIT liability and plant additions in the relevant period); Application, Exhibit F-1, Lines 2-22 (reflecting the differences in the original book and tax bases and showing that they are due to expensing of repairs); *see also* Case No. 2022-00222, May 25, 2023 Order at 5, FN 19 (discussing how Atmos acknowledged that FXA01 only recorded differences arising from repair deductions).

Normalization rules only apply to ADIT arising from accelerated tax depreciation, and the IRS has specifically stated that normalization rules do not apply to ADIT associated with repair deductions.[21] Thus, the bulk of the ADIT generated in Atmos's 2023 and 2024 fiscal years would not be subject to normalization rules, and therefore, it would not be necessary to include NOL ADIT, if any, offsetting that ADIT liability to avoid a normalization violation.

However, although the Commission does not agree that the exclusion of all projected NOL ADIT would result in a normalization violation, because Atmos failed to establish that it would arise from Kentucky operations,[22] the Commission acknowledges that such a violation could have negative consequences for Atmos and its customers in future rate cases.[23] Further, only the ADIT reflected in FXA02, which consisted of $(145,830) on a prorated basis,[24] is subject to federal normalization rules. Because that amount is not large and the consequences of a normalization violation could be significant, the Commission will offset the ADIT reflected in FXA02 by a corresponding amount in NOL ADIT in this case only to avoid any potential normalization violation, but otherwise finds that there should be no NOL ADIT offset for the reasons discussed above.

[21] *See* Private Letter Ruling 113227-19, 2020 WL 1071276 (issued Dec. 3, 2019) (finding, among other things, that book-tax timing differences arising from repairs, are not subject to normalization rules); *see also* 26 C.F.R. § 1.167(l)-1(h)(1)(i) (requiring a utility's reserve for deferred taxes to reflect the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of accelerated depreciation); *see also* Case No. 2022-00222, May 25, 2023 Order at 5-6 (discussing how Atmos acknowledged that the repair deductions reflected in account FXA01 are not subject to normalization rules).

[22] *See Matter of Missouri-American Water Company*, 637 S.W.3d 121, 127-128 (Mo. App. 2021).

[23] *See* 26 U.S.C.A. § 168(f)(2) (stating that accelerated depreciation may not be used for "public utility property" if the "taxpayer does not use a normalization method of accounting").

[24] Application, Exhibit F, Line 26.

With this adjustment,[25] the Commission finds that the prorated net ADIT offset reflected in Line Number 12 of Exhibit B of Atmos's revenue model should be $(4,926,003)[26] as opposed to $(787,709) and that Atmos's PRP rates should be amended to reflect that change.

<u>Prior Period True-Up</u> – Atmos proposed to true-up its PRP project expenditures from fiscal year 2022, October 2021 through September 2022, which includes a project cost true-up and a revenue recovery true-up.[27] In the May 19, 2022 final Order in Case No. 2021-00214, the PRP was rolled into base rates and reset to $0 through September 2022.[28] The Commission has prohibited true-up for amounts rolled into base rates, when explicitly addressed.[29]

More importantly, Atmos requested rehearing in Case No. 2021-00214 seeking clarification regarding how its PRP rates for fiscal year 2022 should be trued-up in future PRP rates and specifically proposed to true them up in the PRP rates for its 2024 fiscal year. The Commission initially granted rehearing to investigate whether such a true-up would be proper and how it would function. After conducting discovery on the issue and allowing both Atmos and the Attorney General to brief the issue, the Commission agreed

[25] Since the accumulation of ADIT liability is dependent on investments in plant in service in a given year, any changes to plant in service would result in additional changes to the ADIT liability booked in account FXA01. As noted below, the Commission made adjustments to plant in service for fiscal year 2024 and reflected the additional changes in the ADIT liability as part of that adjustment.

[26] *See Application*, Exhibit F, Line 11 (reflecting the prorated ADIT liability recorded in account FXA01 for the PRP period ending September 2024).

[27] Application, Exhibits B, B-2 and B-3.

[28] Case No. 2021-00214, *Electronic Application of Atmos Energy Corporation for an Adjustment of Rates* (Ky. PSC May 19, 2022), Order at 20.

[29] *See, e.g.,* Case No. 2021-00185, *Electronic Application of Delta Natural Gas Company, Inc. for an Adjustment of its Rates and a Certificate of Public Convenience and Necessity* (Ky. PSC Jan. 3, 2022), final Order at 21;

with the Attorney General that the true-up should not be permitted. Among other things, the Commission found Atmos's PRP tariff did not contemplate a true-up for a PRP program year when the PRP rate was rolled into base rates in the middle of the PRP program year and that a true-up under such circumstances could result in Atmos recovering the same costs in both its base rates and its PRP rates in violation of KRS 278.509. The Commission also found that Atmos failed to establish how the true-up would occur in a manner that ensured it did not recover the same costs in both base and PRP rates in violation of KRS 278.509.[30] Thus, the Commission ordered that "[n]o true-up of the October 2021 to September 2022 PRP program year shall be permitted."[31]

The Commission notes that the rehearing Order in Case No. 2021-00214 was never appealed by Atmos. Further, for the reasons expressed therein, the Commission again finds that Atmos's tariff did not contemplate a true-up under the circumstances and that allowing such a true-up could result in costs being recovered in both base and PRP rates in violation of KRS 278.509. The Commission also notes that Atmos provided no information that would allow the Commission to ensure that the true-up would not result in the double recovery of costs that were initially in the PRP rate but were rolled into base rates.[32] Thus, the Commission finds that the prior-period true-up should be denied, which will reduce the revenue requirement by $1,876,588.[33]

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[30] Case No. 2021-00214, *Electronic Application of Atmos Energy Corporation for an Adjustment of Rates* (Ky. PSC June 15, 2023), Order at 7-10.

[31] Case No. 2021-00214, June 15, 2023 Order at 7-11.

[32] *See* Application, 2023-07-31_Atmos_KY_PRP_Filing_-_Model_2023-00231.xlsx, Tabs Exhibit B, Exhibit B-2, and Exhibit B-3 (showing, among other things, that the amount "approved" for recover was $4,558,954, despite the fact that no PRP rate was approved for the relevant period, and providing a plugged number with no details to demonstrate the amount actually recovered).

[33] Application, Exhibit B.

<u>Aldyl-A Pipe</u> – In Case No. 2009-00354, the Commission first approved a PRP rider for Atmos's accelerated replacement of 250 miles of bare steel pipe and services at an estimated cost of $124 million over 15 years.[34] Atmos subsequently discovered an additional 100 miles of bare steel pipe on its system and, in Case No. 2017-00308, sought to substantially increase its PRP spending.[35] The Commission approved the new PRP rider rates, but held that the significant cost increase warranted a more detailed review of Atmos's PRP, which it conducted in Atmos's then-pending rate case, Case No. 2017-00349.[36]

In Case No. 2017-00349, the Commission held that bare steel pipeline replacement projects could not be funded at the levels estimated by Atmos for the PRP program years of 2019 through 2022.[37] The Commission limited Atmos's annual PRP investment to $28 million and extended by two years the original 15-year time period for Atmos to complete the replacement of bare steel pipe.[38]

In Case No. 2018-00281, an application for a general rate adjustment, Atmos sought approval to increase its non-PRP capital investments to accelerate the replacement of aging non-bare-steel facilities, primarily Aldyl-A pipe and other early

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[34] Case No. 2009-00354, *Application of Atmos Energy Corporation for an Adjustment of Rates* (Ky. PSC May 28, 201O); See also Case No. 2017-00349, *Electronic Application of Atmos Energy Corporation for an Adjustment of Rates and Tariff Modifications* (Ky. PSC May 3, 2019), Order at 37.

[35] Case No. 2017-00308, *Electronic Application of Atmos Energy Corporation for PRP Rider Rates* (Ky. PSC Oct. 27, 2017), Order.

[36] Case No. 2017-00349, *Electronic Application of Atmos Energy Corporation for an Adjustment of Rates and Tariff Modifications* (Ky. PSC May 3, 2019), Order.

[37] Case No. 2017-00349, May 3, 2019 Order at 40.

[38] Case No. 2017-00349, May 3, 2019 Order at 41.

polyethylene pipes.[39] The Commission found that Atmos simply shifted the capital it expected to spend on bare steel pipe replacement through its PRP to non-PRP projects and sought to recover the costs in base rates. The Commission also found that safety concerns did not warrant the accelerated replacement of all Aldyl-A pipe, and that projected capital spending on non-PRP projects should be limited to a rolling 5-year average. The Commission stated that "[p]rioritizing individual non-PRP projects within that limit on capital spending is a task to be performed by Atmos."[40]

The Commission noted that Atmos performs a risk-based assessment of its distribution system and prepares a Distribution Integrity Management Plan (DIMP). The Commission held that non-PRP capital spending must be consistent with DIMP. The Commission further held that if non-PRP capital spending (such as Aldyl-A pipe replacement) exceeds the 5-year rolling average, Atmos should "be prepared to provide supporting documentation showing how each project is consistent with its DIMP."[41]

In Case No. 2021-00214, Atmos applied to expand its PRP to include the accelerated replacement of Aldyl-A pipe on its system based on the higher leak rate of Aldyl-A pipe compared to coated steel pipe and other types of polyethylene pipe.[42] The Attorney General opposed expansion of the PRP to include the accelerated replacement of all Aldyl-A pipe, arguing that Atmos had failed to establish that this pipe posed a sufficient safety risk to justify its request.

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[39] Case No. 2018-00281, *Electronic Application of Atmos Energy Corporation for an Adjustment in Rates* (Ky. PSC May 7, 2019), Order.

[40] Case No. 2018-00281, May 7, 2019 Order at 24.

[41] Case No. 2018-00281, May 7, 2019 Order at 25.

[42] Case No. 2021-00214, *Electronic Application of Atmos Energy Corporation for an Adjustment of Rates* (filed June 30, 2021).

In direct testimony filed in support of the request, a witness for Atmos stated that the company was proposing an incremental replacement of the Aldyl-A pipe on its system and that there was no need to replace all the pipe immediately. The witness stated that the company would apply its DIMP to prioritize which sections to replace based on factors such as age of material, location of the pipe in relation to population, and relative risk from third party damage.[43] In response to a Commission Staff data request, Atmos stated:

> Atmos Energy's DIM plan considers Material and Weld Failures as a primary threat to the Distribution system. The DIM Plan further mentions failures of Aldyl-A materials and other industry identified vintage plastics as a sub-threat under the primary threat of Material and Weld Failures. In the most recent DIM model risk-ranking, Material failures were identified as being a high-risk in Kentucky. Upon further review of these material failures it was determined that Aldyl-A Plastic was contributing to these high risks.[44]

The Commission approved inclusion in Atmos' PRP of the three specific Aldyl-A pipe replacement projects in Cadiz, Kentucky, identified in Atmos's application. The Commission rejected Atmos's request to expand its PRP to include the accelerated replacement of all Aldyl-A pipe and held that the inclusion of future Aldyl-A projects in the PRP would be determined on a case-by-case basis. The Commission stated an application to include additional projects "should at minimum include safety justifications for such projects."[45]

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[43] Case No. 2021-00214, *Electronic Application of Atmos Energy Corporation for an Adjustment of Rates* (filed June 30, 2021), Atmos's Direct Testimony of T. Ryan Austin (Austin Direct Testimony), at 27.

[44] Case No. 2021-00214, (filed Aug. 23, 2021), Atmos's Response to Commission Staff's Second Request for Information, Item 30.

[45] Case No. 2021-00214, May 19, 2022 Order at 60.

In Case No. 2022-00222, Atmos applied to include two additional Aldyl-A pipe replacement projects in Cadiz and one in St. Charles, Kentucky.[46] In direct testimony filed in support of the application, Atmos's witness stated that in selecting these projects, the Company took into consideration "factors such as age of material, location of the pipe in relation to population and high consequence facilities, and relative risk from third party damage as described above. All three of the proposed projects ranked high in risk factors in the Company's assessment."[47]

In response to a Commission Staff question if Atmos had identified additional segments for Aldyl-A replacement projects once the work in Cadiz and St. Charles has been completed, Atmos stated:

> The system is reviewed annually and a list of the top 100 pipe segments are generated that are considered to be the higher risk areas based on historical and current data from the past year. This list changes from year to year due to population density, new facilities being installed, or ongoing record reviews, but certain sections of Aldyl-A in Mayfield, Adairville and Spottsville continually rank near the top of the list and would be under consideration for potential replacement following Cadiz and St. Charles.[48]

The Commission found that the three proposed Aldyl-A projects were reasonable and therefore approved their inclusion in Atmos's PRP.[49]

In its current application, Atmos seeks approval to include four additional Aldyl-A projects in its PRP, two in Cadiz, Kentucky, one in Paducah, Kentucky, and one in Horse

[46] Case No. 2022-00222, May 25, 2023 Order at 2-3.

[47] Case No. 2022-00222, (filed July 29, 2022) Atmos's Direct Testimony of T. Ryan Austin, at 7.

[48] Case No. 2022-00222, (filed Sept. 16, 2022) Atmos's Response to Commission Staff's First Request for Information, Item 9(d).

[49] Case No. 2022-00222, May 25, 2023 Order at 3.

Cave, Kentucky. In support of its request for inclusion of the projects in Cadiz, Atmos states that rocky bedding conditions have over time led to increased cracking and leaks in the pipe. Atmos states tracer wire installed with the pipe has also deteriorated over time, which has made the pipeline in Cadiz difficult to locate in response to excavator locate requests. Both projects in Cadiz involve pipe that is entirely pre-1973 Aldyl-A vintage and has a higher relative susceptibility to cracking and leakage.[50]

The proposed project in Paducah involves pre-1973 vintage Aldyl-A pipe that was installed in 1968. According to Atmos, the pipe is located predominantly around the Pierce Lackey Housing Authority in a relatively high-density population area and near Morgan Elementary School. Atmos stated that the Aldyl-A pipe in this project is extremely difficult to locate and poses a higher relative risk of damage from excavation.[51]

The proposed project in Horse Cave also involves pre-1973 vintage Aldyl-A pipe. According to Atmos, this pipe is located in a commercial district that includes general stores, a gas station, a water district office, and a fire department. Atmos stated that due to its location and the difficulty of locating the pipe, it considers this pipeline to pose one of the highest relative risks of failure on its system.[52]

The Commission finds that the annual cap of $28 million on PRP investment imposed in Case No. 2017-00349 remains appropriate and reasonable to complete replacement of high-risk bare steel pipe by the 2027 deadline while protecting Atmos's ratepayers from unreasonable rider rates. While the Orders in Case Nos. 2021-00214

[50] Application, Direct Testimony of T. Ryan Austin (Austin Direct Testimony) at 5-6.

[51] Austin Direct Testimony, at 6-7.

[52] Austin Direct Testimony, at 7-8.

and 2022-00222 did not explicitly discuss the $28 million cap on Atmos's PRP, neither stated that the cap was no longer applicable. Further, for the reasons discussed in the previous orders, the Commission finds that Atmos's PRP investment should continue to be subject to a cap, but that it should be raised to $30 million. As noted in previous cases, the cap should not prevent Atmos from making necessary safety improvements and recovering such costs through base rates, but rather, limits the accelerated recovery of certain investments through the PRP rider, in which an accelerated review process makes discovery regarding individual projects difficult.

The Commission also finds that Atmos failed to establish that the Aldyl-A pipe replacement projects added to the in the PRP in fiscal year 2024 should be included. As noted above, Atmos's witness in the previous case stated that Atmos would use its DIMP to prioritize pipeline segments for replacement. The DIMP refers to Atmos's written integrity plan required by federal pipeline safety regulations.

Specifically, federal pipeline safety regulations require each operator of a gas distribution system to develop and implement a written integrity management plan.[53] Each written integrity plan must identify the following categories of threats to its distribution system:

> . . . corrosion (including atmospheric corrosion), natural forces, excavation damage, other outside force damage, material or welds, equipment failure, incorrect operations, and other issues that could threaten the integrity of its pipeline. An operator must consider reasonably available information to identify existing and potential threats. Sources of data may include incident and leak history, corrosion control records (including atmospheric corrosion records), continuing

[53] 49 C.F.R. § 192.1007.

> surveillance records, patrolling records, maintenance history, and excavation damage experience.[54]

Once risks are identified, the operator must evaluate and rank the risk of each threat to its distribution system. This evaluation must consider:

> . . . each applicable current and potential threat, the likelihood of failure associated with each threat, and the potential consequences of such a failure. An operator may subdivide its pipeline into regions with similar characteristics (e.g., contiguous areas within a distribution pipeline consisting of mains, services and other appurtenances; areas with common materials or environmental factors), and for which similar actions likely would be effective in reducing risk.[55]

Reliance on Atmos's DIMP in choosing pipeline safety projects is important to ensure that Atmos is making investments in the projects that create the highest risk. Prioritizing projects based on the DIMP also provides a quick method for assessing whether a project is needed, which is necessary when reviewing PRP projects given the expedited review anticipated by the PRP rider. While it indicated that the proposed Aldyl-A projects are high priority, Atmos did not indicate that the projects proposed herein ranked the highest on its DIMP or explain why they should be prioritized over specific projects that rank higher, including why the projects should be prioritized over higher ranking bare steel projects in this and subsequent years. Thus, absent significant discovery not anticipated by the PRP rider, the Commission is not able to find that safety concerns justify including the Aldyl-A projects proposed in fiscal year 2024 in the PRP rider, and therefore, finds that the costs associated with the Aldyl-A projects proposed to

[54] 49 C.F.R. § 192.1007(b).

[55] 49 C.F.R. § 192.1007(c).

be added in this PRP program year should be removed from the PRP revenue requirement calculation.

The Commission also finds that in any future PRP application by Atmos that includes a project to replace pipeline segments other than bare steel pipe, Atmos should demonstrate that the project is consistent with the evaluation and ranking of threats to its distribution system in its DIMP. Specifically, Atmos should show either that the Aldyl-A pipe segment is risk-ranked ahead of bare steel and other Aldyl-A pipe the replacement of which would be deferred due to the spending cap or that specific operational circumstances justify replacement of the Aldyl-A segment ahead of higher ranked bare steel or Aldyl-A segments.

The Aldyl-A projects Atmos proposed would be added to rate base in the PRP program year for fiscal year 2024 represented $3,419,512 in installation costs across three accounts.[56] Retirements associated with all projects were projected as a percentage of plant additions to each relevant account such that a reduction in plant additions to an account in each month would result in a corresponding reduction in projected retirements.[57] The cost of capital, depreciation expense, and other expenses included in the calculation of the PRP revenue requirement associated with the projects were also tied to plant in service and rate base.[58]

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[56] *See* Application, Exhibit K-2.

[57] *See* Application, Exhibit K-2, Lines 3, 29, and 54.

[58] *See* Application, 2023-07-31_Atmos_KY_PRP_Filing_-_Model_2023-00231.xlsx (showing the revenue requirement calculation at the tab entitled Exhibit B and indicating how the work papers in other tabs follow into the revenue requirement calculation through the formulas).

However, no proposed in service dates were provided for the proposed PRP projects such that it was not possible to assess the timing of plant additions from the information provided in the application. Because Atmos did not provide information regarding the timing of plant additions, the Commission finds that it would be reasonable to reflect to the removal of the Aldyl-A projects from the relevant plant accounts in equal parts each month. Removing the Aldyl-A projects from the relevant plant accounts in that manner results in a net change in rate base of $(1,364,519) based on a $(1,702,316) change in net plant in service and a $337,797 change in ADIT.[59] The adjustments to remove the costs associated with the Aldyl-A projects, along with those mentioned above, result in a PRP revenue requirement of approximately $4,493,517 as shown on Appendix A attached hereto.

Rate Design

Atmos's most recent base rate case was approved by the Commission in Case No. 2021-00214.[60] 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 most recently concluded base rate case.[61] The rates in the Appendix B attached to this Order should produce PRP revenue requirement, with the adjustments

[59] The change in ADIT is actually an increase in rate base and reflects a reduction in the ADIT liability that arose due to repair reductions in FXA01. As noted above, Atmos's workpapers tie the accumulation of most of its ADIT liability to plant additions based on the percentage of plant additions it expects to immediately expense as repairs for tax purposes, which creates an initial book-tax cost difference. When the plant additions associated with the Aldyl-A projects are removed, there is a corresponding reduction in the ADIT liability accumulated during the PRP period. There would be a smaller change in the ADIT liability arising in account FXA02, but since the Commission assumed those amounts were being offset by NOL ADIT that change would not be reflected in the revenue requirement.

[60] Case No. 2021-00214, May 19, 2022 Order.

[61] PSC KY No. 2, Second Revised Sheet No. 38.

discussed above, of approximately $4,493,517. The Commission finds that those rates are fair, just and reasonable, and should be approved for service effective October 1, 2023.

IT IS THEREFORE ORDERED that:

1. The PRP rates proposed by Atmos are denied.

2. The PRP rates in Appendix B to this Order are approved for service rendered by Atmos on and after the date of entry of this Order.

3. Atmos may use the PRP ROE approved in this Order in its next PRP filing without filing ROE testimony.

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 setting out the rates approved herein and reflecting that they were approved pursuant to this Order.

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

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ENTERED

SEP 29 2023 rcs

KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2023-00231 DATED SEP 29 2023

Line Number	Description		Total		As filed		Difference
1	Project Additions	$	43,322,954	$	45,032,710	$	1,709,756
2	Project Retirements	$	(8,438,743)	$	(8,771,670)	$	(332,927)
3	**Net Change to Gross Plant**	$	34,884,211	$	36,261,040	$	1,376,829
4							
5	Cost of Removal to Accumulated Depr.	$	2,257,756	$	2,257,756	$	0
6	Retirements from Accumulated Depr.		8,438,743		8,771,670		332,927
7	Depreciation Accrual to Accumulated Depr.		(488,973)		(496,413)		(7,440)
8	**Net Change to Accumulated Depreciati**		10,207,526		10,533,013		325,487
9							
10	**Net Change to Net Plant**	$	45,091,737	$	46,794,053	$	1,702,316
11							
12	Accumulated Deferred Income Taxes		(4,588,206)		(787,709)		3,800,497
13	**Net Change to Rate Base**	$	40,503,531	$	46,006,344	$	5,502,813
14							
15	Rate of Return		6.94%		6.94%		
16	**Required Operating Income**	$	2,809,325	$	3,191,000	$	381,675
17							
18	Depreciation & Amortization Expense		631,092		656,883		25,791
19	O&M Savings		(8,640)		(8,640)		0
20	Ad Valorem Tax Increase		339,931		353,348		13,417
21	Income Taxes on Cost of Service Items		(240,115)		(249,897)		(9,782)
22	Income Taxes on Adjusted Interest Expense		(180,461)		(204,979)		(24,518)
23	**Operating Income at Present Rates**	$	541,807	$	546,715	$	4,908
24							
25	Deficiency	$	3,351,132	$	3,737,715	$	386,583
26	Tax Factor		74.58%		74.58%		0.00%
27	**Total Rate Adjustment**	$	4,493,517	$	5,011,885	$	518,368
28						$	-
29	Project Cost True-up	$	-	$	343,863	$	343,863
30	Revenue Recovery True-up		-		1,532,726		1,532,726
31	**Total True-up**	$	-	$	1,876,588	$	1,876,588
32						$	-
33	**Total Rate Adjustment**	$	4,493,517	$	6,888,473	$	2,394,956

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2023-00231 DATED SEP 29 2023

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.

Pipeline Replacement Program Rider Rates

	Monthly Customer Charge	Distribution Charge per Mcf	
Rate G-1 (Residential)	$ 0.00	1-300 Mcf	$0.2494
		301-15,000 Mcf	$0.2494
		Over 15,000 Mcf	$0.2494
Rate G-1 (Non-Residential)	$ 0.00	1-300 Mcf	$0.1831
		301-15,000 Mcf	$0.1273
		Over 15,000 Mcf	$0.1273
Rate G-2	$ 0.00	1-15,000 Mcf	$0.0640
		Over 15,000 Mcf	$0.0525
Rate T-3	$ 0.00	1-15,000 Mcf	$0.0448
		Over 15,000 Mcf	$0.0367
Rate T-4	$ 0.00	1-300 Mcf	$0.0744
		301-15,000 Mcf	$0.0516
		Over 15,000 Mcf	$0.0427

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