COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF ATMOS ENERGY CORPORATION FOR AN ORDER APPROVING SYSTEM DEVELOPMENT RIDER	)))	CASE NO. 2014-00275

ORDER

On July 31, 2014, Atmos Energy Corporation ("Atmos") tendered for filing an application for approval of a System Development Rider ("SDR"). By letter dated August 11, 2014, the Commission notified Atmos that its application was rejected for filing based on deficiencies related to the requirements of 807 KAR 5:001, Section 16, Applications for General Adjustments of Existing Rates. On October 15, 2014, the Commission issued an Order in this matter accepting Atmos's application, granting its request for deviations, and suspending the effective date of the proposed SDR tariff. On February 4, 2015, the Commission issued an Order correcting the filing and suspension dates. Atmos participated in two informal conferences ("IC") with Commission Staff ("Staff") and responded to two Staff requests for information. Although the Office of the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("AG"), attended the first IC for informational purposes, there are no intervenors in this case. On February 13, 2015, Atmos notified the Commission that it waived its opportunity for a hearing in this matter and filed a motion that its Supplemental Testimony be accepted for inclusion in the record in this proceeding. The Commission accepts Atmos's filing of Supplemental Testimony, and the case now stands submitted based on the record in this proceeding.

BACKGROUND

This application represents Atmos's third request for an SDR which, according to the language of Atmos's proposed tariff, "is intended to encourage economic development and job growth by allowing the Company to recover operational expenses, capital investment or both associated with the expansion and/or improvement of infrastructure to existing and/or new service areas." The tariff is mirrored after Atmos's Pipeline Replacement Program ("PRP") tariff, which allows for recovery of investment in pipeline replacement between rate cases pursuant to KRS 278.509.

Atmos's first request for approval of an SDR occurred in Case No. 2012-00066,[1] in which Atmos requested authority to establish, along with an Economic Development Rider and a Margin Loss Recovery Rider, an SDR to recover any investment related to economic development initiatives for overall system improvement or reliability and that cannot be directly assigned to a customer or group of customers. The Commission did not approve either the SDR or the Margin Loss Rider in Case No. 2012-00066 because Atmos did not provide notice to its customers of these proposed rate riders and because of its finding that the establishment of these riders was best addressed in the context of a base rate proceeding.

[1] Case No. 2012-00066, *Application of Atmos Energy Corporation for an Order Approving Economic Development Riders* (Ky. PSC Aug. 27, 2012).

Atmos requested the SDR again in its 2013 rate case, Case No. 2013-00148.[2] The SDR rate was proposed to be charged to firm and interruptible General Sales Service Rate G-1 and G-2 rate classes in proportion to their relative base revenue share approved in Atmos's most recent general rate case. In response to a request for information from Staff in that proceeding, Atmos stated that it had undertaken no projects since 2009 that would qualify for the SDR, and that it currently had no projects planned that would qualify. Without an SDR, Atmos claimed it will need to file rate cases more frequently if it undertakes economic development projects that cause it to experience revenue deficiencies. The Commission denied the SDR in its final Order in Case No. 2013-00148, saying that its denial was without prejudice for Atmos to request an SDR again in the future if it experiences increasing opportunities for projects that would qualify for such a mechanism.

Atmos filed the instant application following its receipt of a June 4, 2014 letter from the Mayor of the city of Hopkinsville, Kentucky ("Hopkinsville"), which requested that Atmos extend its system to two unserved areas of the community. According to Atmos, the potential projects were not economically feasible, but it believed that the projects met the spirit and intent of its past SDR applications.[3] Atmos informed Staff in an August 28, 2014 IC that the mayor's letter requested an extension of Atmos's system to an industrial park where a Walmart distribution center, a medical facility, and a manufacturing plant are currently located, and then to a Tennessee Valley Authority designated megasite. Atmos stated there are currently no customers at the Megasite,

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[2] Case No. 2013-00148, *Application of Atmos Energy Corporation for an Adjustment of Rates and Tariff Modifications* (Ky. PSC Apr. 22, 2014).

[3] Amended Application at paragraph 5, filed Sept. 30, 2014.

and that it was not aware of any potential customers. Atmos stated that it considered the extension request as a single project with an estimated cost of construction of $16.6 million.[4] Because Hopkinsville would not agree to contribute financially to the project, Atmos stated that the only way for it to pursue this project was with an SDR tariff through which it could recover its investment and related operating expenses. Atmos proposed to recover from its sales and transportation customers $2.07 million in annual SDR revenues to pay for the investment in this project and related expenses.

On September 29, 2014, independent of this proceeding, the Hopkinsville Water Environment Authority ("HWEA") submitted to the Commission's Executive Director's office a copy of a Request for Proposal and construction plans, which included a gas main extension covering the same area as Atmos's proposed SDR project. Atmos informed the Commission on October 28, 2014, that it had been unaware of the HWEA project until it received the Commission's October 15, 2014 Order, including requests for information which questioned Atmos's knowledge of the project. On October 29, 2014, Atmos met with the Hopkinsville mayor and city administrator, the president of HWEA, and with a representative of the Fort Campbell army base regarding the HWEA project.[5] Atmos stated that the mayor told the company that the projects outlined in his earlier letter to Atmos would be undertaken through the contractual agreement between HWEA and Fort Campbell.

In spite of the loss of the project for which it originally sought recovery through the proposed SDR tariff and rates, Atmos continues to request approval of the SDR tariff. On December 4, 2014, Atmos filed a revision of its proposed SDR tariff showing

[4] Staff IC Memo, filed Sept. 4, 2014.

[5] Atmos's Updated Response to Staff's First Request for Information, Item 3, filed Nov. 10, 2014.

proposed rates of $0 for all rate classes. Atmos stated that even though cost recovery of the Hopkinsville projects was no longer needed, it continues to believe that the SDR mechanism will add economic development value to the communities it serves, and that having it available for qualifying projects would position Atmos to act quickly with potential solutions in the future. This belief was reiterated in the February 13, 2015 Supplemental Testimony, which contained additional information regarding economic development opportunities in its service territory that are specific to the cities of Bowling Green and Shelbyville. Atmos states that economic growth in both of these communities will be facilitated by the removal of barriers related to cost of infrastructure and timing of infrastructure installation, which the proposed SDR would address.

The proposed tariff describes the calculation of the SDR revenue requirement as consisting of the following:

- SDR-related Plant In-Service not included in base gas rates minus the associated SDR-related accumulated depreciation and accumulated deferred income taxes;
- Retirement and removal of plant related to SDR construction;
- The rate of return on the net rate base being the overall rate of return on capital authorized for the Company's Pipe Replacement Program Rider;
- Depreciation expense on the SDR-related Plant In-Service less retirements and removals; and
- Adjustment for ad valorem taxes.

The tariff caps annual SDR investment at $5 million unless it receives advance approval from the Commission for incremental investment over $5 million.

DISCUSSION

Atmos states that the proposed SDR tariff is "nearly identical" to those proposed in Case Nos. 2012-00066 and 2013-00148.[6] The Commission notes, however, that the Purpose section of the previously proposed tariffs contained a statement limiting SDR investment recovery to those initiatives that could not be directly assigned to a customer or group of customers. The fact that the Hopkinsville project consisted of two specifically identifiable unserved areas in which three specific potential customers were known,[7] suggests that customers connecting to extensions in those areas could have been directly assigned the cost of the extensions in some manner. It is therefore questionable that the Hopkinsville project, which gave rise to this application, would have been eligible for previous versions of the SDR tariff. Otherwise, Atmos's proposed SDR tariff differs from the two proposed previously in that it allocates costs to both sales and transportation customer classes instead of just the sales classes, and it caps annual SDR investment at $5 million unless it receives advance approval from the Commission for incremental investment over $5 million.

Through the process of discovery, which began with post-hearing data requests in Case No. 2013-00148 and continued throughout this proceeding, Atmos has provided information sufficient to compare its proposed SDR tariff to various riders, surcharges, trackers, and other forms of natural gas infrastructure expansion activity which have occurred in other states. Atmos states that eight states appear to have mechanisms

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[6] Amended Application, Testimony of Mark A. Martin, at 9.

[7] Atmos stated that the Hopkinsville mayor's letter requested that it extend natural gas service to an industrial park where a Walmart distribution center, a medical facility, and a manufacturing plant are currently located, Staff IC Memo, filed Sept. 4, 2014.

similar to its proposed SDR.[8] However, the information provided by the American Gas Association ("AGA") and filed by Atmos[9] shows that, with the possible exception of the Georgia Strategic Infrastructure Development and Enhancement Program, the infrastructure expansion mechanisms referenced by Atmos were either required by legislation, provide for pre-planning on the part of the utility, provide for advance commission approval, provide for only new customers benefiting from the expansion paying the cost of the expansion, or include a combination of these. A review of the entire list of 28 states included in the AGA State Infrastructure Expansion Activity compendium shows that nine are northeast states attempting large-scale regional development of the states' natural gas infrastructure in unserved or underserved areas; 10 of the 28 have enabling legislation providing for gas expansion to rural, unserved, or under-served areas; and in 10 of the 28, the cost of extensions are borne by the new customers benefiting from the extensions.

In its post-hearing data response in Case No. 2013-00148 and in responses to requests for information in this case, Atmos confirmed that Atmos MS[10] has a Supplemental Growth Rider ("SGR"). The Atmos MS SGR tariff provides for the MS Development Authority, the MS PSC, and PSC Staff to be consulted in the selection process for projects subject to investment recovery through the SGR tariff. Actual project revenues generated from the SGR investment are used to offset the SGR revenue requirement. The Atmos MS SGR tariff is a five-year pilot. In comparison,

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[8] Atmos's Response to Staff's Data Request from the Nov. 13, 2014 IC, Item 1.d., filed Dec. 4, 2014.

[9] *Id.*

[10] Atmos MS is the Mississippi division of Atmos Energy Corporation.

Atmos KY's proposed tariff is proposed to be permanent, provides for an after-the-fact approval process consisting of a review of projects and their respective costs for inclusion in the SDR rate, requires prior Commission approval only if annual investment exceeds $5 million, and provides no revenue off-set to reduce the impact on customers between rate cases.

In information Atmos provided concerning the Virginia NEED legislation, Atmos confirmed that the statute requires that eligible infrastructure development costs for qualifying projects be reduced by the non-gas base revenue received from providing sales or transportation service to the customer occupying the qualifying project as well as from any other customer served directly from the eligible infrastructure. The statute also requires that the gas utility receive a binding commitment prior to the initiation of service for a level of service of at least 50 percent of the capacity of the proposed facilities for a period of at least five years, or for a financial guaranty of at least 50 percent of the gas utility's estimated investment in the proposed project. Atmos reiterates that the intent of Atmos KY's proposed SDR program is to encourage economic development and job growth with the expansion and/or improvement of its infrastructure to new and/or existing service areas, which may or may not be able to provide for a binding commitment or 50 percent threshold. Although one version of Atmos's SDR tariff, which it filed during the processing of this proceeding, included a sentence stating: "The Company can only use this Rider for announced projects and those projects must be accompanied by an increase in jobs", Atmos stated in response to a Staff request for information that this sentence was from a prior version of the tariff page which it had inadvertently filed.[11] With regard to the issue of revenue offsetting SDR costs, Atmos points out that it designed its SDR to be like the PRP program, with any approved SDR rates zeroing out at the conclusion of a subsequent rate case. Atmos pointed out that in both Mississippi and Virginia, its respective operating divisions can make use of annual review mechanisms, the Stable Rate Filing, and the Annual Information Filing, respectively, with an elevated return which it is not proposing in Kentucky.[12] Atmos stated that if the Commission prefers an alternative to an SDR Rider, it would be open to a similar annual review of rates.[13]

Based on the evidence of record, the Commission finds that Atmos's proposed SDR tariff should be denied due to its lack of safeguards for Atmos's customers. In addition to the lack of requirements for pre-planning on the part of Atmos and pre-approval on the part of the Commission unless investment is over $5 million annually, it has no provision for SDR investment costs to be offset by incremental revenue; requires no threshold level of increased load; requires no financial commitment from any other party; and gives the presumption of reasonableness for localized investment in possibly uneconomic extensions to be spread over Atmos's entire body of customers. Some, if not all, of the safeguards against these omissions are included in various other infrastructure extension programs and mechanisms referenced by Atmos in the record of this proceeding, and having no safeguards appears to be the exception and not the rule.

[11] Atmos's Response to Staff's Data Request from the Nov. 13, 2014 IC, Item 2, filed Dec. 4, 2014.

[12] Supplemental Testimony of Mark A. Martin at 5-6, filed Feb. 13, 2015.

[13] Amended Application, Testimony of Mark A. Martin, at 12.

The Commission further finds that any future filing for an SDR tariff on the part of Atmos should include, at a minimum: 1) a requirement for Commission pre-approval of all SDR projects to ensure they are not overly speculative, do not constitute wasteful duplication of services, and that they do not require Certificate of Public Convenience and Necessity proceedings pursuant to KRS 278.020 and 807 KAR 5:001, Section 15; and 2) a requirement that revenues from customers served as a result of SDR extensions be used to off-set costs of SDR extensions. Atmos should endeavor to include as many customer safeguards as possible if it chooses to pursue a system expansion mechanism in the future.

IT IS THEREFORE ORDERED that:

1. Atmos's proposed SDR is denied.

2. Any future application for a system expansion mechanism or program shall include the customer and company protection features described herein.

By the Commission

ENTERED
MAR 27 2015
KENTUCKY PUBLIC
SERVICE COMMISSION

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