

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

RATE ADJUSTMENT OF WESTERN	)	CASE NO. 90-013
KENTUCKY GAS COMPANY	)	

O R D E R

IT IS ORDERED that Western Kentucky Gas Company ("Western") shall file the original and 15 copies of the following information with the Commission, with a copy to all parties of record, by January 4, 1991. Each copy of the data requested should be placed in a bound volume with each item tabbed. When a number of sheets are required for an item, each sheet should be appropriately indexed, for example, Item 1(a), Sheet 2 of 6. Include with each response the name of the witness who will be responsible for responding to questions relating to the information provided. Careful attention should be given to copied material to ensure that it is legible. Where information requested herein has been provided with the original application, in the format requested herein, reference may be made to the specific location of said information in responding to this information request.

1. On page 6, line 18, of his testimony Mr. Hagemann makes reference to Internal Revenue Code Section 167(1) "and the regulations thereunder." Provide a copy of the Internal Revenue Code Section(s) and the appropriate regulation(s) to which Mr. Hagemann refers.

2. a. Beginning on page 8, line 23 of his testimony Mr. Hagemann states "The Minnesota Commission accepted the normalization requirements of Subsection 167(h) and Subsection 168(f) associated with deferred taxes and agreed that the pre-acquisition deferred taxes are eliminated and, therefore, cannot reduce rate base." Provide a copy of the document that sets forth such conclusions by the Minnesota Commission.

b. Provide copies of all other pertinent documents, i.e., Orders and reports of the Minnesota Public Utilities Commission case referred to on pages 8 and 9 of Mr. Hagemann's testimony.

c. With regard to the case cited in Mr. Hagemann's testimony before the Minnesota Public Utilities Commission, provide a narrative explanation of any discussions dealing with the treatment of excess deferred taxes. Provide any supporting documentation.

d. In Mr. Hagemann's opinion, do the IRS normalization rules apply to what is considered to be excess deferred taxes? Provide the basis for the response. Also, provide copies of any Private Letter Rulings dealing with the treatment of excess deferred taxes in an asset sale purchase.

3. Provide a copy of the Order and other pertinent documents from the Iowa Department of Commerce in Docket No. RPU-86-11, referenced on page 9 of Mr. Hagemann's testimony.

4. Provide a copy of Private Letter Ruling No. 87305011.

5. Provide the amount, if any, of unamortized investment tax credit not subject to recapture, on the books of Western at September 30, 1990.

6. On page 266 of Western's 1988 Annual Report submitted to the Commission, it is noted at line 15 "Investment Tax Credits transferred to Atmos Energy Corporation in Dallas." Provide a detailed explanation of this notation.

7. On page 8, beginning at line 12 of his testimony Mr. Fischer states that he has reviewed the activities of the marketing representatives and proceeds to give a breakdown of the percentage of time spent on different aspects of their jobs. Provide all documentation of any studies or analyses that form the basis of Mr. Fischer's conclusions.

8. Provide a list of all utility cases in which Mr. Hagemann has participated. The list should include the name of the utility company, the docket number, the regulatory agency, and the pertinent issues involved.

9. a. Provide Exhibit MSL-R4 with an additional column showing the revenue requirement impact of the acquisition changes if the transaction had not been afforded IRC Section 338(h)(10) treatment.

b. Based on Mr. Hagemann's understanding of the tax code, what would have occurred on Western's books with regard to the deferred taxes if it had not made the election under Section 338(h)(10) to treat the purchase as an asset purchase? Provide all assumptions and supporting calculations relied on to present

the effect on the balance sheet of the stock purchase without the Section 338(h)(10) election.

c. Provide copies of any and all memos, letters or other documents that provide information leading to or influencing the decision by Atmos to elect Section 338(h)(10) treatment for the acquisition. Specifically, provide copies of all correspondence between Atmos and Fred Goldberg of Skadden Arps, that pertain to the decision to afford Section 338(h)(10) treatment to the transfer.

10. Provide a comparison of the economic impact to the ratepayers of the loss of accelerated depreciation resulting from the treatment given in the Commission's Order versus the ability to take advantage of accelerated depreciation and Investment Tax Credits ("ITC").

11. Provide the amount of the actual tax liability incurred by TAE at the time of acquisition.

12. Provide copies of all correspondence between Atmos and TAE concerning the purchase price of Western.

13. Provide information on all cases before regulatory bodies of which you are aware, where a utility's rate base was reduced or a similar rate-making adjustment was made as a result of the loss of ITC or deferred taxes in an acquisition.

14. At what point during the acquisition were the deferred taxes and ITC's eliminated? Explain whether this occurred when Texas American Energy ("TAE") transferred the assets of Western to Western Kentucky Gas Utility Corp. ("WKGUC") or when Atmos

purchased the WKGUC stock. Provide copies of journal entries supporting this response.

15. Provide an analysis of the portion of the purchase price paid for Western which is attributable to the cost to be borne by TAE for taxes that came due at the time of the transfer. Provide all supporting documentation for this response.

16. Provide copies of all studies that were performed to determine the economic impact of the transfer upon the ratepayers of Western.

17. Beginning at page 20 of her testimony Ms. Lovell points out what she perceives to be several errors in the Commission's calculations. Provide the detailed calculation of the Commission's adjustment as Ms. Lovell would have determined it "assuming some validity to the underlying theories."

18. What election did Western (or TAE) make under IRS Code Section 46(f) with regard to the rate treatment of ITC? Provide the year the election was made and any supporting documentation.

19. Explain the rate treatment applied to deferred income taxes in Case No. 9556.<sup>1</sup>

20. Explain the effect on the ratepayers, from a cash flow standpoint, of the normalization approach to accounting for income taxes. Also explain the impact on the ratepayers of the elimination of deferred taxes, in the asset sale.

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<sup>1</sup> Case No. 9556, Rate Adjustment of Western Kentucky Gas Company, dated October 31, 1986.

21. Explain how the ratepayers of Western have been compensated for the deferred taxes of \$12.8 million which were eliminated in the acquisition of Western by Atmos. Include in this discussion, consideration of the various components of deferred taxes which were specified in the September 13, 1990 rate Order which were the temporary differences related to the deferred taxes at 34 percent, the permanent losses related to excess deferred taxes, and the ITC.

22. Provide the source and any related workpapers used to derive the balances of investment tax credits of \$94,916 for pre-1971 and \$3,077,238 for post-1971 ITC, contained in Ms. Lovell's testimony at page 18.

23. a. Provide a copy of all tax forms and schedules filed by TAE which contain the state and federal income tax treatment of Western's deferred income taxes and ITC subsequent to the sale of Western.

b. Provide detailed state and federal income tax depreciation schedules which show the depreciable basis in Western's assets immediately after the purchase by Atmos and for each subsequent tax return.

24. Provide the source and any related workpapers for the determination of the amount of Western's ITC which was subject to recapture stated in Ms. Lovell's testimony at page 18. Also, provide the determination of the amortization rates and the amount which would have been amortized from the date of the sale to September 30, 1990.

25. Provide a detailed breakdown, including all supporting calculations and assumptions used in the determination, of each amount of the deferred taxes of \$12.8 million, into pre-1971 ITC, post 1971 ITC, excess deferred taxes resulting from the reduction in the federal income tax rate under the Tax Reform Act of 1986 ("TRA"), deferred state taxes, excess deferred state income taxes, and any other categories deemed appropriate.

26. Explain the benefits to the ratepayer of normalization versus flow-through rate-making treatment of income taxes.

27. Provide an analysis of the total effect on the capital costs of Western resulting from the acquisition by Atmos in 1987. Include complete details of all assumptions and calculations used in the analysis and reconcile the capitalization to the pre- and post-acquisition balance sheets of Western.

28. Provide the revenue requirement effect of the changes in capital costs, determined in the previous question, over the same 12-year period used in the study contained in Mr. Brown's testimony. Explain all assumptions and calculations used in the study.

29. Under the scenario in Question 28, provide the 12-year analysis making the assumption of the loss of accelerated depreciation, and the rate-making treatment provided by the Commission in September 1990.

30. Provide an analysis of what the total effect on capital costs would have been if the purchase in 1987 by Atmos had been treated as a stock purchase rather than an asset purchase. Explain all assumptions and calculations used in the analysis.

31. Provide the revenue requirement effect of the changes in capital costs identified in the previous question over the 12-year period used in the study contained in Mr. Brown's rebuttal testimony. Explain all assumptions and calculations used in the analysis.

32. Provide the annual revenue requirement affects of the study included in OCB-1. Include all assumptions and calculations used in the analysis.

33. Provide all supporting workpapers for OCB-1 and OCB-2. If the studies are conducted on PC spreadsheet programs, provide a data disk containing the analysis as originally submitted and as modified in this data request. Also identify the computer software requirements and the PC system requirements to run the analysis.

34. Explain any provisions of the IRS normalization rules relating to the regulatory determination of the tax and book basis of assets acquired in a taxable asset purchase. Include copies of all supporting documents.

35. a. Explain all economic advantages received by Western in electing to treat the purchase as an asset purchase rather than a stock purchase. Aside from the previously stated benefits of assuming no liability for TAE's non-utility debts, explain the economic impact on Western of treating the purchase as an asset purchase rather than a stock purchase. Provide copies of any studies performed by or for Atmos in its determination of the most economically beneficial method of acquisition.



b. Explain the impact of each of these economic advantages on the ratepayers.

c. Explain how the arrangement to treat the purchase of Western as an asset purchase, rather than a stock transaction, after consideration of all tax implications and other economic impacts, was the most prudent approach for both the ratepayers and the stockholders.

36. Provide an explanation by Mr. Hagemann of how the ratepayers of Western are compensated for the \$12.8 million dollars they invested in Western through tax normalization prior to the transfer which was eliminated in the recording of the transfer.

37. Explain any means available to regulators to provide compensation to ratepayers for their investment in deferred taxes prior to a transfer that would not violate IRS normalization rules.

38. In Mr. Hagemann's opinion, does the failure to provide a return on the plant acquisition adjustment result in a similar reduction to rate base which would also violate normalization rules? Explain your response.

39. Mr. Hagemann stated that he has discussed his testimony and conclusions with members of his firm dealing with telecommunications issues, and that they agreed with his conclusions.

a. Provide copies of any information from private letter rulings, court cases, etc., which supports their agreement with Hagemann's conclusions.

b. Provide a description of the treatment of deferred taxes in the AT&T divestiture case and provide copies of any IRS or court rulings related to the transfer of deferred taxes from AT&T to the operating companies.

c. Is the IRS treatment afforded AT&T consistent with or different from the treatment suggested in Western's case? Provide a full explanation of similarities or differences.

40. With regard to the rehearing testimony of Mary S. Lovell, page 25, provide support for the statements that "If Western reduces its work force, deletes services and otherwise manages to reduce its other operating costs to stay within the revenue constraints of the Order, the overall return on invested capital provided by the Rate Order is 8.95%, not 11.20%. The return to Western's equity investors is 7.09%, not 12.5%." Specifically, provide the underlying assumptions, calculations, and any necessary explanations to support the assumed overall return of 8.95 percent and the assumed return on equity of 7.09 percent.

41. Provide the underlying assumptions, calculations, and any necessary explanations to support the statement on pages 26-27 of the Lovell testimony that "The equivalent required return on equity is 18.3%."

42. Provide any publicly available evidence, including rating agency opinions, investment survey reports (e.g. Value Line, et al.), analysis of Atmos's stock price movements, etc., which supports Western's position that the Commission's treatment of deferred income taxes and the acquisition adjustment have increased Western's riskiness and hence its cost of equity.

Done at Frankfort, Kentucky, this 14th day of December, 1990.

PUBLIC SERVICE COMMISSION

  
For the Commission

ATTEST:

  
Executive Director