COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

In the Matter of:

APPLICATION OF ATMOS ENERGY	)	
CORPORATION FOR AN ADJUSTMENT	)	Case No.
OF RATES AND TARIFF MODIFICATIONS	)	2013-00148

SUPPLEMENTAL AND CORRECTED DIRECT TESTIMONY

OF

BION C. OSTRANDER

PUBLIC VERSION

ON BEHALF OF

KENTUCKY OFFICE OF ATTORNEY GENERAL

FILED: NOVEMBER 18, 2013

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CASE NO. 2013-00148

SUPPLEMENTAL AND CORRECTED DIRECT TESTIMONY OF

BION C. OSTRANDER

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1. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Bion C. Ostrander. My business address is 1121 S.W. Chetopa Trail, Topeka, KS 66615-1408.

Q. WHAT IS YOUR OCCUPATION?

A. I am President of Ostrander Consulting. I am an independent regulatory consultant and a Certified Public Accountant ("CPA") with a permit to practice in Kansas.

Q. **WHY ARE YOU FILING AMENDED TESTIMONY?**

A. I am filing supplemental and corrected testimony (and related revised exhibits) to address changes in the amount of OAG's proposed adjustments related to OAG Adjustment 4 (payroll costs) and OAG Adjustment 5 (long-term incentive costs). The changes in these adjustment amounts cause the OAG's proposed revenue requirement to increase from $1,215,895 (my October 9, 2013 direct testimony) to $2,736,433 per this amended testimony, as shown at Revised Exhibit BCO-2, Schedules A-1 and A-2.

This supplemental and corrected testimony will make it easier (and more timely) for all parties to understand the reasons for the changes in these two adjustments in advance of the scheduled hearing. I have not changed the underlying reasons for my adjustments, just the adjustment amounts.

The changes in these two OAG adjustments will be explained in more detail in amended portions of this testimony addressing Adjustment 4 and 5, although these changes are summarized below:

OAG Adjustment 4 Payroll Costs – The change in this adjustment was caused by two issues: 1) an error in my supporting Excel workpaper calculations; and 2) an error in Atmos' payroll tax amounts reported at FR 16(13)(g) per Schedule G-1 of Mr. Densman direct testimony (also cited at

OAG 1-117) which only shows payroll tax expense and does not include capitalized payroll taxes.

<u>OAG Adjustment 5 Long-Term Incentives</u> – It was not clear to me from Atmos data request responses which amounts of LTIP/Restricted Stock Plan incentives were included in the forecasted test period so I included both amounts from OAG 2-61 and OAG 2-58 to avoid understating this adjustment, and now Atmos has clarified the amount of incentives included in the test period and I have reduced the amount of my adjustment accordingly.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?

A. I am testifying on behalf of the Kentucky Office of the Attorney General ("OAG") in this rate case proceeding regarding Atmos Energy Corporation ("Atmos") request for substantial rate relief.

Q. PLEASE SUMMARIZE YOUR PROFESSIONAL EXPERIENCE AND EDUCATIONAL BACKGOUND.

A. Please see Exhibit BCO-1 for more information regarding my professional experience and educational background. In summary, I am an independent regulatory consultant and a practicing CPA with a specialization in regulatory issues. I have over thirty-three years of regulatory and accounting experience. I have addressed many regulatory issues in numerous state jurisdictions and on an international basis.

I started my consulting practice in 1990, Ostrander Consulting, after leaving the Kansas Corporation Commission ("KCC"). I previously served as the Chief of Telecommunications for the KCC from 1986 to 1990, and was the lead witness on most major issues. I served as Chief Auditor for the KCC from 1983 to 1986, addressing issues regarding telecom, gas, electric, and transportation. In addition, I have worked for international and regional accounting firms, including Deloitte, Haskin and Sells (now Deloitte).

I received a Bachelor of Science degree in Business Administration with a major in Accounting from the University of Kansas in 1978. I am a member of the American Institute of CPAs ("AICPA") and the Kansas Society of CPAs ("KSCPA").

Q. WHAT TYPE OF REGULATORY ISSUES HAVE YOU ADDRESSED?

A. I have addressed many regulatory issues in my career. My experience includes addressing issues related to rate cases under rate of return ("ROR") regulation and TIER requirements, alternative regulation/price cap plans, management audits, specialized accounting and regulatory issues, and other matters.

I have addressed a broad range of issues in my career, including retail and wholesale cost studies, competition, affordable rates/universal service, service quality, infrastructure/modernization, specialized accounting matters, affiliate transactions, income taxes, sale/leaseback, compensation, cross-subsidization, depreciation, rate design, sales/acquisitions and many other matters.

During my tenure at the KCC, I addressed major regulatory issues in the energy and telecom field, including the substantive transition in the telecom industry ranging from the break-up of AT&T and the related introduction of long distance competition, the transition from rate of return regulation to alternative/incentive regulation, the proliferation of alternative carriers, the introduction of the Kansas Relay Service (for speech and hearing impaired persons), and the expansion of services and technology.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE KENTUCKY PUBLIC SERVICE COMMISSION ("COMMISSION") OR ANY OTHER UTILITY REGULATORY COMMISSION?

A. I testified before the Commission in the Big Rivers Electric Corporation ("BREC") rate case in Case No. 2012-00535.[1] In addition, I have testified in numerous other jurisdictions and this information is provided at Exhibit BCO-1.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The primary purpose of my testimony is to address adjustments to Atmos' rate application and sponsor the overall revenue requirement using a traditional rate-of-return ("ROR") on rate base approach. I am not sponsoring testimony related to rate of return, rate design, cost of service, and tariff issues. I will incorporate all adjustment amounts in the revenue requirement calculations at Exhibit BCO-2.

In summary, I will address the following issues:

1) Overall revenue requirement.

2) Individual rate case adjustments.

3) The problems with using Atmos' forecasted test period.

[1] Application of Big Rivers Electric Corporation for a General Adjustment in Rates, Case No. 2012-00535, Direct Public and Confidential Testimony filed May 24, 2013.

Q. CAN YOU SUMMARIZE THE TYPE OF EXHIBITS THAT YOU ARE SPONSORING?

A. Yes, I am sponsoring three types of Exhibits:

1) Exhibit BCO-1 is my curriculum vitae.

2) Exhibit BCO-2, Schedule A-1 summarizes OAG's proposed adjustments and revenue requirements calculation (compared to the revenue requirement of Atmos', along with related supporting schedules showing the detailed adjustments as appropriate.

3) Various other exhibits – These various exhibits include documents that support my testimony.

Q. WILL YOU SUMMARIZE YOUR TESTIMONY?

A. Atmos' application shows a revenue requirement of $13.4 million.[2]

The total impact of OAG recommended adjustments increases operating income and results in a proposed revenue requirement of $2.7 million, and this is a reduction in Atmos' original revenue requirement of $10.7 million.

Q. DID ATMOS USE A FULLY FORECASTED TEST PERIOD?

A. Yes. Atmos used a fully forecasted test period for the twelve month period December 1, 2013 through November 30, 2014. Atmos also uses a

[2] Martin Direct, p. 9, line 13, identifies a revenue increase of $13,367,575.

base period for the twelve month period August 1, 2012 to July 31, 2013, which includes seven months of actual historical data for the period August to February 2013 and five months of estimated data for the period March 2013 to July 2013. Although Atmos' forecasted test period filing appears to be technically compliant with Kentucky statutes, I have concerns with this forecasted filing regarding its lack of documentation, methodology, and specific impacts on costs (and this specific level of detail is not addressed in state statutes).

Q. ARE YOU USING ATMOS' FULLY FORECASTED TEST PERIOD ENDING NOVEMBER 30, 2014 AS THE STARTING POINT FOR ADJUSTMENTS IN THIS CASE?

A. Yes. Although I do not agree with Atmos' use of a fully forecasted test period, the OAG has no other reasonable alternative but to use this same forecasted data as the starting point for adjustments. It would be almost impossible, and certainly impractical, for OAG to attempt to put its own rate case together based on the most recent historical test period. To attempt to put together a completely different rate case filing based on twelve months of historical data would be extremely time consuming, costly, and would create further confusion and problems for the

Commission. In order to be on the same, equal footing of Atmos in preparing an alternative rate case using historical data, the OAG would require virtually the same access as Atmos has to its financial records, operational records, and all other studies and analysis that might affect issues in this case. Clearly these conditions are not going to be met, so the OAG will use Atmos' forecasted test period as the starting point for adjustments.

Q. DO YOU BELIEVE THAT "FAIR, JUST AND REASONABLE RATES" (AS REQUIRED BY STATE STATUTE) CAN BE ACHIEVED VIA ATMOS' FULLY FORECASTED REVENUE REQUIREMENT?

A. No, but my adjustments to Atmos' filing are closer to making the rates fair, just and reasonable.

KENTUCKY OFFICE OF THE ATTORNEY GENERAL RATE OF RETURN

Q. WHAT IS THE PURPOSE OF INCLUDING A RATE OR RETURN ("ROR") IN YOUR REVENUE REQUIREMENT SCHEDULES?

A. First, I want to make it clear that I am not testifying as a ROR witness in this rate case. I am including a ROR in the OAG revenue requirement schedules and calculations as a placeholder for a ROR to be determined by the Commission at a later date. The OAG is not sponsoring a specific ROR witness, so it is necessary to include a ROR placeholder to complete my revenue requirement schedules. The revenue requirements calculation would not be complete without a ROR placeholder component, and the ROR placeholder that I have included is 7.63%.

Some of the ROR's in recent cases that were considered as placeholders are shown below:

1) 7.63% ROR – Potomac Electric Power Company – Public Service Commission of Maryland.[3]

2) 7.29% ROR - Northern Utilities Inc. d/b/a UNITIL – The Maine Public Utilities Advisory Staff issued a Bench Analysis that proposes a ROR of 7.29%.[4]

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[3] In the Matter of the Application of Potomac Electric Company for an Increase in its Retail Rates for the Distribution of Electric Energy, Public Service Commission of Maryland, Case No. 9311, issued July 12, 2013, Appendix I, page 174.

[4] *Northern Utilities Inc. d/b/a UNITIL Proposed Increase in Base Rates (35-A MRSA Section 307)*, State of Maine Public Utilities Commission, (Corrected) Bench Analysis, Docket No. 2013-00133, dated September 12, 2013, page 15.

KENTUCKY OFFICE OF THE ATTORNEY GENERAL PROPOSED ADJUSTMENTS

ADJUSTMENT OAG-1-BCO – REMOVE DUPLICATE MAINTENANCE FEES ON LEGACY CUSTOMER INFORMATION SYSTEM ("CIS")

Q. WILL YOU SUMMARIZE ADJUSTMENT OAG-1-BCO (EXHIBIT BCO-2, SCHEDULE A-3)?

A. OAG 2-35 and OAG 1-96 asked Atmos about the propriety and reasonableness of duplicate maintenance fees of $1,400,000 for the legacy (prior) CIS and $2,328,150 for the new customer service system ("CSS") which went live on May 1, 2013. Atmos' response to OAG 2-35(c) admits that it was not appropriate to include duplicate maintenance fees for both customer service centers and that the legacy maintenance fees should be removed from the forecasted test period. Atmos' response to OAG 2-35(b) identifies the Atmos' Kentucky-allocated portion of legacy maintenance fees as $51,262 prior to the application of the 2.7% inflation factor. Because I have removed the impact of Atmos' proposed inflation factor adjustment in the next rate case adjustment that I will propose, it is appropriate to use $51,262 as the adjustment for these legacy maintenance fees.

ADJUSTMENT OAG-2-BCO – REMOVE THE IMPACT OF ATMOS' 2.7% GENERIC INFLATION FACTOR APPLIED TO EXPENSES

Q. WILL YOU SUMMARIZE ADJUSTMENT OAG-2-BCO (EXHIBIT BCO-2, SCHEDULE A-4)?

A. This adjustment removes the impact of Atmos' 2.7% generic inflation factor adjustment from applicable O&M expenses, and reduces related expenses of $496,907. Atmos has failed to meet a reasonable burden of proof regarding this adjustment because: 1) they have failed to show a direct correlation between the actual historical change in these expenses and the 2.7% inflation increase, and; 2) Atmos has not provided additional justification or supporting documentation and calculations for this adjustment.

Q. WILL YOU SUMMARIZE SOME OF THE PRIMARY REASONS SUPPORTING YOUR ADJUSTMENT?

A. Yes. Some of the primary reasons for removing the impact of Atmos' generic inflation factor adjustment include the following:

1) Atmos has not met a reasonable burden of proof regarding this adjustment and has not adequately demonstrated that there is a direct or proper correlation between the 2.7% generic inflation factor and the actual historic changes in the O&M expenses to which Atmos applies this inflation factor.

2) Atmos uses this 2.7% generic inflation factor to improperly forecast increases in various O&M expenses, but many of these same expenses have actually experienced decreases for the most recent fiscal period 2011 to 2012. Thus, Atmos' use of the inflation factor is opposite of what is actually occurring, because it increases expenses that have actually decreased based on historical experience.

3) Atmos does not cite to any supporting documentation or calculations for this adjustment and none could be readily located.

4) Atmos' Schedule D 2.2 (per FR 16(13)(d)2.2) is a list of Atmos proposed adjustments and Adjustment 3 states that the expense reduction of $799,537 represents the forecasted change in expenses (except labor, benefits, rent, and bad debt) from the base period to the forecasted test period and includes a 2.7% inflation factor adjustment. However, Atmos never separately identifies how much of this adjustment is related to a forecasted reduction in expenses and how much is related to a forecasted offsetting increase in expenses related to the 2.7% inflation factor impact.

5) Atmos does not explain if it calculated a 2.7% inflation increase to both the base period and the forecasted test period related expenses.

6) Although Atmos uses the 2.7% generic inflation factor to increase numerous O&M expenses, Atmos admits that it never uses a specific "productivity factor" or "deflation factor" in its forecasting process to reflect decreases in expenses - - Atmos adjustment and forecasting process is biased and one-sided to promote unnecessary and improper increases in expenses.

7) Atmos' generic inflation factor uses data from the Consumer Price Index ("CPI"), but the make-up of the actual CPI "basket of goods and services" is not representative of Atmos' expenses (or Atmos' "basket of goods and services") to which it applies the CPI inflation factor, and this inconsistency is not reconciled or addressed by Atmos.

8) The use of the 2.7% generic inflation factor is an indication of the problems and inaccuracy with Atmos' forecasting process used in this rate case.

Q. HOW DOES ATMOS' EXPLAIN ITS FORECASTING PROCESS THAT USES A 2.7% GENERIC INFLATION FACTOR TO INCREASE ITS EXPENSES?

A. Mr. Densman[5] briefly explains in two sentences that Atmos' forecasting process applies a 2.7% inflation factor to increase all O&M expenses except labor, benefits, rent, and bad debts (insurance is an exception that is increased at 5%), and this is based on average inflation using the CPI for the Midwest region for the three-year period 2010 to 2012.[6] Mr. Densman does not explain if the 2.7% generic inflation factor is applied to both the base period and forecasted test period and he does not cite to supporting documentation or calculations for this adjustment. Atmos' Application does not provide any additional explanation, supporting documentation, or calculations to justify increasing expenses using the 2.7% generic inflation factor.

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[5] Densman Direct, p. 15, lines 19 to 23.

[6] The calculation of the 3-year average CPI inflation factor is shown at Atmos' response to OAG 1-111.

Q. CAN YOU EXPLAIN ATMOS' FAILURE TO PROVIDE SUPPORTING DOCUMENTATION AND CALCULATIONS FOR THE 2.7% INFLATION FACTOR ADJUSTMENTS?

A. OAG sought Atmos' supporting calculations and the amount of the expense increase (by account/category) related to the 2.7% inflation factor in at least five data requests, but Atmos did not provide this information. OAG 1-111(b) and (c) asked for a reconciliation from historical expenses to the base period and forecasted test period expenses for each adjustment and change in cost (along with supporting documentation, calculations, and assumptions), and although this would have fully disclosed the amount of the inflation adjustment, Atmos did not provide information or calculations that readily identified the impact of the 2.7% inflation adjustment.

OAG 1-112(a) asked Atmos to explain and show how the 2.7% inflation rate was applied to cost elements in the forecasted test period (this would have shown the amount of increase for each cost element related to the inflation factor), but Atmos did not provide the total amount of the increase (and did not provide the amount of increase for each type of expense) related to the inflation factor.

Atmos' response to OAG 2-51 stated that the 2.7% inflation factor was applied to all cost elements (except labor, benefits, rent, and bad debt) that are listed at Mr. Densman's Direct Testimony Exhibit JCD-1, although this exhibit does not provide or show any calculations related to the 2.7% inflation factor adjustment.

Also, both OAG 1-86 and Staff 1-59 asked for supporting workpapers and calculations (including working Excel versions) for Atmos' adjustments, but it does not appear that Atmos provided any supporting documents for the 2.7% inflation adjustment.

Q. DID ATMOS EXPLAIN IF IT APPLIED THE 2.7% INFLATION FACTOR TO BOTH THE BASE PERIOD AND FORECASTED TEST PERIOD EXPENSES?

A. No, I did not notice that Atmos explained this in testimony or related responses to OAG data requests. Also, Atmos' proposed Adjustment 3[7] does not explain how much of this adjustment is related to other forecasted reduction in expenses and how much is related to the offsetting increase in the inflation factor adjustment.

[7] Schedule D 2.2 (per FR(16)(13)(d)2.2)

Q. HAS ATMOS MET A REASONABLE BURDEN OF PROOF REGARDING THIS ADJUSTMENT AND TO DEMONSTRATE THE CORRELATION BETWEEN THE INFLATION FACTOR AND ATMOS' ACTUAL CHANGE IN EXPENSES?

A. No. Mr. Densman's brief testimony and Atmos' responses to OAG data requests do not meet a reasonable burden of proof and do not provide adequate explanation or supporting documentation to demonstrate that there is a direct or reasonable correlation between the 2.7% inflation factor and the <u>actual historical change</u> in expenses to which the inflation factor is applied. In fact, Atmos' response to OAG data requests demonstrates just the opposite.

OAG 1-112(b) asked Atmos to explain and provide supporting documentation to show the correlation between actual historical changes in expenses and the 2.7% inflation increase that Atmos used for these same expenses. Atmos' response to OAG 1-112(b) states, "…there is no direct correlation as inflation is only one of these factors." It appears that even Atmos agrees there is no direct correlation between actual changes in expenses and the 2.7% inflation factor used for increasing these expenses. Atmos admits that inflation is "just one factor" to be considered in the change of expenses, but Atmos did not specifically identify the other factors.

Also, Atmos' response to OAG 1-112 referred to Attachment 1 of the response which showed historical changes in expenses subject to Atmos' 2.7% inflation factor adjustment. However, the information shown at Attachment 1 actually supports a conclusion contrary to Atmos' position, and this information is displayed in Table BCO-1 below. Atmos applied a 2.7% increase to all eleven categories of expenses identified at OAG 1-112 Attachment 1, although at least seven categories of these expenses experienced actual decreases in amounts for the most recent historical periods available and all combined expenses showed an overall decrease in amount (comparing the change from 2011 to 2012 as shown in Table BCO-1 below). Table BCO-1 shows a total decrease of $470,563 for all of these expenses that were subject to Atmos' 2.7% inflation factor increase. Atmos did not explain or provide supporting documentation to demonstrate why expenses that have an actual recent history of decreases in amounts should be increased by a generic 2.7% inflation factor in this rate case. Atmos' position in this regard is unreasonable, unjustified and does not meet a reasonable burden of proof.

<u>Table BCO-1</u> - Actual Historical Decrease in Expenses is Contrary to Atmos' 2.7% Inflation Factor Increase for These Same Expenses

	Type of Expense	Fiscal 2011		Fiscal 2012	Change
1	Vehicles & Equip	967,528	-16%	817,068	(150,460)
2	Materials & Supplies	593,269	-1%	586,880	(6,390)
3	Information Technologies	11,932	47%	17,550	5,617
4	Telecom	214,653	5%	224,999	10,345
5	Marketing	156,529	-12%	137,577	(18,952)
6	Directors & Shareholders & PR			128	128
7	Dues & Donations	80,016	-56%	35,264	(44,752)
8	Print & Postages	11,024	14%	12,583	1,559
9	Travel & Entertainment	344,255	-36%	219,260	(124,995)
10	Training	21,482	-41%	12,732	(8,750)
11	Miscellaneous	407,065	-33%	273,152	(133,913)
	Expenses Subject to Inflation Factor	**$ 2,807,755**		**$ 2,337,191**	**$ (470,563)**

Q. ALTHOUGH ATMOS APPLIED A 2.7% INFLATION INCREASE TO EXPENSES THAT HAVE PREVIOUSLY DECREASED BY $470,563, DID YOU PROPOSE ANY ADJUSTMENTS TO REDUCE THESE EXPENSES?

A. No, I only removed the impact of Atmos' 2.7% inflation factor adjustment in this specific adjustment. The limited information that Atmos did provide for these expenses shows an actual decrease of $470,563 for the most recent comparative periods available, so I will take this into consideration as I evaluate other adjustments in this rate case.

Q. WHY DID YOU REMOVE "OUTSIDE SERVICES" EXPENSES FROM YOUR PRIOR ANALYSIS INCLUDED AT TABLE BCO-1?

A. Atmos' response to OAG 1-112 indicated that a 2.7% inflation factor was applied to Outside Services, although these expenses increased by $1.6 million or 117% from 2011 to 2012 as shown below.

Type of Expense	Fiscal 2011		Fiscal 2012	Change
Outside Services	1,409,379	117%	3,056,543	1,647,164

This might lead one to incorrectly conclude that applying a 2.7% inflation factor to these costs is reasonable, given the historical increase of $1.6 million and 117% from 2011 to 2012. However, it is clearly inappropriate to apply a generic 2.7% inflation factor to Outside Services regardless of whether these expenses increased or decreased from the prior year amounts.

Outside Services usually reflect payments made to various types of outside professionals and consultants for various recurring and non-recurring services which can fluctuate significantly from one year to the next. Thus, a 117% increase in these expenses from 2011 to 2012 may be the result of significant one-time services related to specialized studies or services that were provided in 2012 and which were not previously provided in 2011. It would not be proper to apply a 2.7% inflation factor to the entire group of Outside Service expenses for 2012 when some of these services and related contracts may not be provided in 2013, 2014, or future years.

Also, it is not appropriate to apply a 2.7% generic inflation factor to the entire group of Outside Services because many of these services are (and should be) subject to underlying written and formal contracts, engagement letters, purchase orders, and responses to Requests for Proposals which guide these costs on a case-by-case basis. Various Outside Services should be based on a contract reflecting a very specific scope of services, including a specific number of hours tied to identified tasks to be performed, and specific hourly billing rates that vary by the specific contractor/consultant providing these services. To take a collective group of contract costs for Outside Services and just increase these costs by a 2.7% inflation factor would be highly inefficient, imprudent, and reflect extremely poor budgeting. This greatly oversimplified approach would assume that every single contractor and outside professional of Atmos will increase their billing rates and their hours by the exact same amount of 2.7%, and that these same contracts will remain in place for each year without any changes in scope or type of services being provided.

Atmos indicates that its forecasted test year costs are based to a large degree upon its internal forecasting process, and if the 2.7% generic inflation factor is in fact one of Atmos' primary internal budget assumptions this causes me great concern. This type of guiding budget assumption would be a general indication that Atmos' budgeting process is flawed, not cost-based, and is biased towards cost increases in this rate case. If the 2.7% generic inflation factor is a routine budget assumption that is applied to Outside Services and other expenses for which there is no direct correlation from historical changes in expenses, then this reflects poorly on the credibility of Atmos' budgeting process.

Q. DID ATMOS USE "PRODUCTIVITY FACTORS" TO DECREASE SOME OF ITS EXPENSES AND TO FAIRLY BALANCE ITS USE OF AN "INFLATION FACTOR" TO INCREASE ITS EXPENSES?

A. No. Atmos' response to OAG 1-112(e) states that no productivity factors were used, but to the extent productivity gains are expected and achievable, they are reflected in the annual budget. However, Atmos does not specifically identify any productivity gains or efficiencies that are reflected in the annual budget or this rate case, and this is consistent with Atmos' responses to other data requests that do not specifically identify any cost savings or efficiencies reflected in this rate case. It seems very inappropriate and one-sided that Atmos imposes a 2.7% generic inflation increase on a significant amount of its total O&M expenses in this rate case (24% of its total O&M expenses), but fails to apply a specific productivity factor to even one single expense category, which would at least give the appearance of some sense of fairness or balance. Again, the credibility of Atmos' budgeting process must seriously be questioned when the Company approach appears geared towards increasing expenses in this rate case without any specific application of cost savings or efficiencies.

Q. HOW DID YOU CALCULATE AN ADJUSTMENT TO REMOVE THE IMPACT OF ATMOS' GENERIC 2.7% INFLATION FACTOR?

A. I did the best I could with the limited information and explanation provided by Atmos. Atmos' response to OAG 2-51 explains that it applied a 2.7% inflation factor to the O&M expenses included at Mr. Densman's Exhibit JCD-1, although this exhibit does not provide the amount of Atmos' inflation adjustment. The supporting calculations for adjustment are shown at Exhibit BCO-1, Schedule 2. To explain briefly, I took the forecasted test period O&M expenses (claimed by Atmos to be subject to the 2.7% inflation factor) and multiplied this amount by the 2.7% inflation factor to determine an expense increase of $248,454 for the forecasted test period. Next, I doubled this inflation factor impact to an amount of $496,907 to reflect an estimated inflation factor impact for the base period increase that Atmos may have carried forward to inclusion in the forecasted test period amounts. This total amount of $496,907 was removed as the estimated impact of Atmos' 2.7% inflation adjustment. If Atmos did not reflect the 2.7% inflation adjustment in both the base period and forecasted test period, then I am not opposed to removing the base period inflation impact from my adjustment.

ADJUSTMENT OAG-3-BCO – ADJUST SHARED SERVICES UNIT ("SSU") AND DIVISION GENERAL OFFICE ("DGO") EXPENSES ALLOCATED TO ATMOS

Q. WILL YOU SUMMARIZE ADJUSTMENT OAG-3-BCO (EXHIBIT BCO-2, SCHEDULE A-4)?

A. Atmos has failed to meet a reasonable burden of proof regarding its proposed significant and unexplained forecasted increases in SSU, DGO, and Kentucky Direct expenses. Atmos failed to provide the most important information requested by OAG, which is an explanation of significant changes in the amount of SSU, DGO, and Kentucky Direct expenses by account and description from 2010 through the forecasted test period. SSU and DGO expenses showed a consistent declining trend of 2% to 4% for the three-year period 2009 to 2011, although the 2012 actual expenses increased by 7%. For the base period and forecasted test period, Atmos increased these forecasted expenses by 30% over these two years (a total amount of $3.0 million) without providing adequate explanation and documentation for this significant increase. In addition, a review of the underlying SSU, DGO and Kentucky Direct expenses for the actual periods 2010, 2011, 2012, and the base period revealed significant and unusual increases in expenses which Atmos did not address. At this time, I am proposing to remove $1,492,500 (or one-half) of of the base period and forecasted test period increases of $2,985,000, which allows an increase in expenses of about 7.5% for the base period and 7.5% for the forecasted test period. This 7.5% increase in SSU and DGO expenses is very reasonable and exceeds the 3-year average actual increase of 4% in these expenses from 2010 to 2012. I believe a similar adjustment could also be appropriate for Kentucky Direct expenses.

Q. REGARDING THE SSU AND DGO ALLOCATED EXPENSES, DO YOU HAVE CONCERNS REGARDING THE LACK OF SUPPORTING DOCUMENTATION AND REQUESTED INFORMATION WHICH ATMOS FAILED TO PROVIDE TO THE OAG?

A. Yes, I have significant concerns. Atmos failed to provide explanations, supporting documentation and calculations to support the SSU and DGO allocated costs in both its testimony and in OAG data requests. Atmos has failed to meet a reasonable burden of proof for these SSU/DGO allocated expenses because it has failed to provide adequate and meaningful supporting documentation, and therefore, my proposed adjustment should be adopted.

Q. CAN YOU PROVIDE A LIST OF SOME OF THE MOST IMPORTANT SUPPORTING DOCUMENTATION THAT ATMOS FAILED TO PROVIDE, ALONG WITH OTHER CONCERNS THAT YOU HAVE IDENTIFIED?

A. Yes, a list of such information and related concerns is summarized below:

1) **No Explanation for Significant Changes in SSU, DGO and Kentucky Allocated Expenses For 2010 Through Forecasted Test Period (OAG 1-154(b))** – Atmos failed to provide the requested explanation and supporting documentation for significant changes in these expenses for each of the years 2010, 2011, 2012, base period, and forecasted test period. Atmos' response to OAG 1-154 did not provide SSU, DGO, and Kentucky allocated amounts for the

forecasted test period and this is a concern because the amounts for the forecasted test period are the most important information in the rate case. It is not clear if most of the SSU, DGO and Kentucky allocated amounts for the base period were also the same for the forecasted test period (to explain why forecasted amounts were not provided), but if that is the case then there is no reconciliation or detailed calculations for forecasted amounts that increased by 20% (or $2.2 million) over the base period expenses.

2) **No Proof That SSU, DGO, and Kentucky Allocated Expenses are Reasonable, Prudent, and Fair (OAG 1-154(f))** - Atmos did not provide any explanation or documentation to show that these expenses are reasonable, prudent and fair. Instead Atmos just referred to its Cost Allocation Manual ("CAM") in response to this data request. However, the Cost Allocation Manual does not establish reasonableness, prudency, and fairness for the underlying specific expenses. Indeed, the CAM only establishes an allocation method and factor for allocation such expenses.

3) **No Proof That SSU, DGO, and Kentucky Allocated Expenses are Reflected at the Lower of Cost or Fair Market Value, or Other Reasonable Amounts (OAG 1-154(c),(d), and (e))** - Atmos did not provide any explanation or documentation to show that these expenses are charged to Atmos at the lower of cost or fair market value, or that these expenses are representative of costs for similar services and products provided by other third-party vendors in the market. Atmos states that it has not performed a study for this requested information. Holding companies and nonregulated affiliates have an incentive to allocate excessive or uneconomic costs to their regulated affiliates in order to recover amounts through the regulatory process which cannot easily be easily recovered elsewhere, and recovery through the regulatory process can allow the holding company/unregulated affiliate to subsidize its more competitive operations.

4) **No Analysis of Reasonableness Test of Allocated Expenses** - Atmos has not provided any analysis or tests to show that the total Administrative and General Expenses (or overhead expenses) of Atmos (including SSU, DGO, and Kentucky Direct) are reasonable or consistent with the industry. If allocated amounts are

unreasonable or excessive this can act as a form of an indirect dividend paid that is reimbursed to the regulated utility to the holding company or other entities.

5) **No Supporting Documentation and Calculations for Shift of Expenses to Kentucky Due to the Sale of Georgia Operations (OAG 1-155(a) and 2-73))** - Atmos proposes an adjustment to shift increased expenses of about $2.6 million to the Kentucky Atmos due to the sale of its Georgia operations, and thus no DGO expenses are being allocated to Georgia. Although OAG 1-155 and 2-73 provide the amount of expenses shifted to Kentucky Atmos due to the Georgia sale, Atmos does not provide the requested supporting documentation and calculations for these amounts. In fact, OAG 2-73 only shows the change in the allocation factor, but does not explain or identify the amount of expenses by account number or description. It is not possible to determine how Atmos calculated this $2.6 million adjustment, the specific types of expenses shifted to Kentucky Atmos, and whether this is reasonable.

6) **Atmos' Workpapers Show Inconsistent Base Period Amounts for SSU, DGO, and Kentucky Allocated Expenses (OAG 1-154 , Exhibit JCD-1, and Schedule I.1))** - For the base period ending July 31, 2013, Atmos' response to OAG 1-154 Attachment 1 does not show the same amount of Kentucky direct expenses, DGO expenses, and SSU expenses that are included in both Exhibit JCD-1 and Schedule I-1, and this difference of $324,252 is not explained or reconciled.[8] It is not clear which source includes the correct amount. However, Atmos' response to OAG 1-154 is the only document that has been provided with amounts for each account number for periods 2010, 2011, 2012, and the base period (the forecasted test period was not provided). Thus, if the amounts in in OAG 1-154 are incorrect, this means that Atmos did not provide accurate SSU, DGO, and Kentucky allocated expenses <u>by account number and description</u> for any data request, and that is because this level of documentation was never provided for amounts in Exhibit JCD-1 and Schedule I-1 as shown in the table below:

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[8] Although the difference of $324,252 may not appear significant between these various documents, the underlying differences and fluctuations between each specific type of expense may be significant.

Table BCO-2: Inconsistent SSU and DGO Expenses from Various Sources

	Base Period Amounts		
	OAG 1-154	Exh. JCD-1	Sch. I-1
Kentucky Direct	$14,593,405	$13,892,232	$13,892,000
Division General Office	$4,042,707	$4,466,231	in below amount
Shared Services Unit	$6,457,216	$6,410,613	$10,877,000
	$25,093,328	**$24,769,076**	**$24,769,000**
Difference between OAG 1-154 and other schedules			$324,252

Q. WILL YOU SHOW THE TRENDS AND CHANGES IN SSU, DGO, AND KENTUCKY DIRECT EXPENSES FROM 2009 THROUGH THE FORECASTED TEST PERIOD?

A. Yes. This information is shown in Table BCO-3 below, and I will address these changes as part of the support for my proposed adjustment.

Table BCO-3: Change in Direct/Allocated Expenses 2009 through Forecasted Test Period

	Most Recent Five Calendar Years				Base Year	Forecast Test Year	Atmos Adjustments - Actual 2012 to Forecasted Test Year
	2009	2010	2011	2012	7/31/2013	11/30/2014	
Direct O&M - KY	**$14,181**	**$11,226**	**$13,366**	**$12,980**	**$13,892**	**$13,626**	
Change Prior Yr.	$1,447	($2,955)	$2,140	($386)	$912	($266)	$646
% Change	11%	-21%	19%	-3%	7%	-2%	5%
SSU + DGO	**$10,071**	**$9,668**	**$9,412**	**$10,086**	**$10,877**	**$13,071**	
Change Prior Yr.	($182)	($403)	($256)	$674	$791	$2,194	$2,985
% Change	-2%	-4%	-3%	7%	8%	20%	30%
Total Expenses	**24,252**	**20,894**	**22,778**	**23,066**	**24,769**	**26,697**	
Change Prior Yr.	$1,265	($3,358)	$1,884	$288	$1,703	$1,928	$3,631
% Change	6%	-14%	9%	1%	7%	8%	14%

Q. CAN YOU EXPLAIN ATMOS' ADJUSTMENT TO SSU AND DGO EXPENSES IN THE CONTEXT OF HISTORICAL CHANGES?

A. Yes, I will be citing to information from Table BCO-3 above and I will primarily focus on the amounts and percentages related to the row titled "SSU+DGO." From 2008 through 2011 there was a consistent trend of reductions for SSU and DGO ranging from 2% to 4%.

In 2012, SSU and DGO expenses increased by a significant and unexplained amount of $674,000 (7% increase), and Atmos failed to provide a response to OAG's data request seeking an explanation for this increase. The 2012 expenses are the most recent actual twelve month period of expenses available (although actual expenses are available from January through July 2013).

In the base period ending July 31, 2013, Atmos forecasted another significant increase of $791,000 (8% increase) for the SSU and DGO expenses, although this consists of seven months of actual data and five months of projected data. This represents two years in a row with significant and unusual increases (7% increase in 2012 and 8% increase in the base period), after three prior successive years decreases in actual SSU and DGO expenses. Moreover, Atmos has failed to provide detailed explanations and supporting documentation (although some or all of this amount may be related to the shift of expenses to Kentucky from Georgia operations as I will address for the forecasted test period increase).

Finally, in the forecasted test period ending November 31, 2014, Atmos projected an increase of $2.2 million and 20%. This increase of $2.2 million is identified at Schedule D.2.2 as Atmos Adjustment 5, but Atmos provides no explanation for this significant increase and only vaguely states that this represents a forecasted amount of expenses allocated from SSU and DGO. Atmos' response to OAG 1-153 appears to indicate that most of this increase of $2.2 million is related to a $2.6 million shift of SSU and DGO expenses to Kentucky due to the sale of Georgia operations on April 1, 2013. According to the company's response to OAG 2-73, Atmos will no longer allocate SSU and DGO expenses to Georgia and these expenses must be absorbed by the remaining other states in the Kentucky/Mid-States Division. However, Atmos never provided any detailed supporting documentation or calculations for the $2.2 million or $2.6 million expense amounts as requested in OAG 1-153 and 2-73. Also, Atmos' response to OAG 1-154 did not provide a column showing SSU and DGO expenses by type and description for the forecasted test period, and so the Atmos' proposed $2.2 million increase for the forecasted test period cannot be reconciled to OAG 1-154. Thus, the reasonableness of the calculation and the type of expenses being shifted could not be evaluated for reasonableness or propriety.

Q. DOES ATMOS' TOTAL PROJECTED INCREASE IN SSU AND DGO EXPENSES LOOK UNUSUAL FOR THE PERIOD BEGINNNING WITH ACTUAL AMOUNTS IN 2012 THROUGH THE FORECASTED TEST PERIOD AMOUNTS AT NOVEMBER 2014?

A. Yes. As indicated in Table BCO-3, the total projected increase in SSU and DGO expenses from the last known actual data in 2012 through the forecasted test period ending November 31, 2014 is about $3.0 million ($2,986,000), which is a 30% increase (15% per year for the 2013-2014 period). This projected increase is very significant and unusual, and is more than double the 2012 actual increase of 7%. In addition, when counting the 7% actual increase in these expenses for 2012, this represents total SSU and DGO increases of $3.7 million and 37% for the period January 1, 2012 through November 31, 2014, for which Atmos has not provided adequate supporting explanation and documentation.

Q. WOULD YOU BE SATISFIED IF ATMOS PROVIDED DOCUMENTATION SHOWING THAT THE $2.2 MILLION FORECASTED TEST PERIOD INCREASE WAS RELATED TO THE SHIFT IN EXPENSES FROM GEORGIA TO KENTUCKY?

A. No. I am not opposed to an adjustment to reflect the shift of expenses from Georgia to Kentucky if proper documentation and calculations can be provided and the amount is reasonably known and measurable (and I have allowed some portion of this increase in my adjustment). However, that does not satisfy all of my concerns regarding the remaining specific underlying forecasted test period expenses of $11.5 million[9] and it does not satisfy me regarding the reasonableness of the specific underlying forecasted expenses comprising the $2.2 million shift to Kentucky. I still have significant concerns that some of these specific underlying expenses are forecasted inaccurately and that some of these expenses should not be recovered in their entirety from ratepayers due to other regulatory policy and concerns. I believe that the adjustment of these other SSU and DGO expenses could offset and even exceed the $2.2 million related to the shift of expenses from Georgia to Kentucky operations.

[9] Forecasted test period SSU and DGO expenses of $13.1 million less claimed $2.2 million of expenses shifted from Georgia to Kentucky.

Q. **CAN YOU PROVIDE SOME EXAMPLES OF OTHER UNUSUAL AND SIGNIFICANT INCREASES IN SSU AND DGO EXPENSES FROM 2010 THROUGH THE BASE PERIOD THAT ATMOS HAS FAILED TO ADDRESS IN DATA REQUEST RESPONSES TO OAG?**

A. Yes. Confidential Exhibit BCO-2, Schedule 7 includes information from OAG 1-154 Confidential Attachment 1, and is a list of certain specific significant increases and/or unusual amounts for SSU and DGO expenses for the periods 2010, 2011, 2012, and the base period. Atmos did not provide the requested explanation of amounts and reasons for unusual or significant changes from year-to-year for these expenses. The unexplained significant changes for each year further justify my proposed adjustment to SSU and DGO expenses.

REVISED ADJUSTMENT OAG-4-BCO – REMOVE UNEXPLAINED SIGNIFICANT INCREASES IN PAYROLL AND BENEFIT COSTS

Q. **WILL YOU EXPLAIN WHY YOU ARE REVISING ADJUSTMENT OAG-4?**

A. Yes. The change in this adjustment was caused by two issues:

1) An error in my supporting Excel workpaper calculations (during the process of preparing my spreadsheet I inserted certain columns and lines which caused mis-alignment and the wrong amounts to appear in other cells).

2) An error in Atmos' payroll tax amounts reported at FR 16(13)(g) per Schedule G-1 of Mr. Densman's direct testimony (also cited at OAG 1-117) which reports expensed and capitalized amounts for Atmos payroll labor costs and benefits, but incorrectly shows only the expensed amount of payroll taxes (and does not also properly include the capitalized amount of payroll taxes). It appears the correct amount of payroll taxes expensed and capitalized are provided at Atmos' response to OAG 1-120 and I have relied on these amounts for this adjustment. My original payroll adjustment did not include the impact of payroll taxes because it was not clear which amounts were correct, and my revised payroll adjustment now includes the impact of payroll taxes and relies on Atmos response to OAG 1-120 for these amounts.

It is important to emphasize that the underlying reasons supporting my payroll adjustment have not changed because: a) I am consistently removing 50% of Atmos' proposed payroll increase; and b) Atmos' proposed and forecasted payroll expense increase is excessive.

Q. WILL YOU SUMMARIZE THIS PAYROLL AND BENEFITS ADJUSTMENT OAG-4-BCO (EXHIBIT BCO-2, SCHEDULE A-7) AND EXPLAIN WHY MR. DENSMAN'S TESTIMONY ON THIS MATTER MAY BE MISLEADING?

A. Mr. Densman briefly addresses Atmos' payroll and benefits issues in about one page of testimony,[10] but he does not disclose the significant amount and unusual nature of Atmos' proposed payroll increase. In fact, Mr. Densman's testimony only discloses that Atmos included a 3% base

[10] Densman Direct, page 14, lines 9 to 23, and page 15, lines 1 to 9.

pay increases for October 2012 and October 2013 in its payroll adjustment. This might lead one to believe that the payroll increase for the base period and forecasted test period was perhaps only 3% per period, or 6% total for the combined base and forecasted test periods. Also, Mr. Densman does not specifically explain that Atmos has also proposed significant increases for SSU and DGO payroll labor, benefits, and payroll tax costs that are allocated to Kentucky operations. In truth, Atmos proposes to increase payroll labor, benefits, and payroll tax expense by 17.31% (or $2.4 million) for the combined base and forecasted test periods (and combined expensed and capitalized payroll is proposed to increase 20.06%)[11], and this is significantly greater than actual prior year increases for which information has been made available by Atmos. Although Atmos proposes to increase total payroll labor, benefits, and payroll tax expense by 17.31%, some of the percentage increases for the individual payroll cost components are significantly larger, including a 46.51% increase in Atmos' Kentucky Direct payroll benefit expense (although the payroll benefits expense increase for SSU & DGO is 17.55%).[12] I am proposing to reduce Atmos' payroll adjustment by $1.2 million, and this will allow a total

[11] This increase is calculated as the difference between the actual payroll and benefits expense at December 31, 2012 compared to Atmos' forecasted payroll and benefits expense for the forecasted test period at November 30, 2014.

[12] Please see Revised Exhibit BCO-2, Revised Schedule A-7 for detailed components and calculations.

payroll labor/benefit/payroll tax increase of $1.2 million (or 8.66%, which is about one-half of Atmos' proposed 17.31% increase) for the base and forecasted test periods.

Q. WILL YOU COMPARE YOUR PAYROLL/BENEFITS EXPENSE ADJUSTMENT TO THE ADJUSTMENT PROPOSED BY ATMOS?

A. Yes. Please see the table that follows, and the first column is most important because it compares my proposed payroll labor, benefits, and payroll tax expense to that proposed by Atmos (for both "Kentucky Direct" and for "SSU & DGO" allocated amounts), and the difference between these two expense amounts is my proposed adjustment. For example, Atmos proposed an increase[13] of $2,425,424 and I proposed an increase of $1,212,712, and the difference of $1,212,712 is my proposed adjustment (because I am proposing to remove one-half (50%) of Atmos' proposed payroll increase, this means that both the amount that I allow and the amount that I disallow are the same amount).

[13] The increase is for the base period and forecasted test period (from fiscal year end 2012 through the forecasted test period ending November 30, 2014.

Table BCO-4: Summary of OAG Payroll/Benefits adjustment by category (Revised Exhibit BCO-2, Revised Schedule A-7, page 2 of 2)

A	B	C	D
Line		Forecasted Test Period	
			Total Expense
	Table BCO-4:	Expense	& Capital
	Kentucky Direct - OAG Adjustment		
1	OAG Actual 2012 Payroll labor, benefits, and taxes	$7,224,401	$15,791,251
2	Atmos Forecasted Payroll labor, benefits, and taxes	$8,865,683	$19,059,057
3	Total Atmos Increase Subject to Adj.	$1,641,282	$3,267,806
4	Atmos Proposed Percent Increase	22.72%	20.69%
5			
6	**SSU & DGO - OAG Adjustment**		
7	OAG Actual 2012 Payroll labor, benefits, and taxes	$6,786,661	$10,752,617
8	Atmos Forecasted Payroll labor, benefits, and taxes	$7,570,803	$12,428,794
9	Total Atmos Increase Subject to Adj.	$784,142	$1,676,177
10	Atmos Proposed Percent Increase	11.55%	15.59%
11			
12	Total Kentucky & SSU/DGO Subject to Adj.	$2,425,424	$4,943,983
13	OAG Adjustment at one-half of increase	0.5	18.63%
14	**OAG Proposed Reduction in Payroll Exp.**	**$1,212,712**	

Q. **WILL YOU ALSO COMPARE THE AMOUNT OF PROPOSED PAYROLL AND BENEFITS EXPENSE INCREASES PROPOSED BY ATMOS AND OAG?**

A. Yes, this information is shown in the table below. This table shows the amount and percentage payroll labor, benefits, and payroll tax expense increases proposed by Atmos and OAG for each category, for the combined base and forecasted test periods subsequent to the actual 2012 period. This table shows that Atmos proposes a total payroll/benefits/tax increase of $2.4 million and 17.31% (or about a 8.66%% increase for each of the base period and forecasted test period), and OAG proposes a total payroll/benefits/tax increase of $1.2 million and 8.66% (or about an 4.33% increase for each of the base period and forecasted test period). The OAG adjustment and OAG allowed increases in payroll/benefits/taxes of $1.2 million and 4.33% for each of the base period and forecasted test period is very fair and reasonable, and it even exceeds averaged payroll/benefit/taxes increase amounts and percentages for all actual prior years 2008 through 2012 that were made available by Atmos. Arguably, I could have reasonably proposed a steeper adjustment.

Table BCO-5: Comparison of OAG and Atmos allowed payroll/benefit increases (Revised Exhibit BCO-2, Revised Schedule A-7, page 2 of 2)

Increase in "Expense"	Atmos Proposed Increase		OAG Proposed Increase	
Type of Payroll	Atmos $	Atmos %	OAG $	OAG %
Kentucky Direct - Payroll	$611,103	12.92%	$305,552	6.46%
Kentucky Direct - Benefits	$1,003,687	46.51%	$501,844	23.26%
Kentucky Direct - Payroll Taxes	$26,492	7.83%	$13,246	3.92%
SSU & DGO - Payroll	$519,373	12.09%	$259,687	6.04%
SSU & DGO - Benefits	$206,419	9.57%	$103,210	4.78%
SSU & DGO - Payroll Taxes	$58,350	17.55%	$29,175	8.78%
Total Expense Increase Proposed	**$2,425,424**	**17.31%**	**$1,212,714**	**8.66%**

Note: OAG proposes an increase of $1,212,712, and a decrease of $1,212,712 (one-half) to Atmos' proposed total payroll expense increase.

Q. CAN YOU EXPLAIN WHY ATMOS' PROPOSED ADJUSTMENT TO PAYROLL AND BENEFITS IS NOT REASONABLE?

A. Yes. I will summarize some of my primary concerns with Atmos' payroll/benefits adjustment, and these are some of the same reasons that support the OAG adjustment below:

1) Atmos' payroll adjustment and related calculations are not transparent and it required numerous data requests to gain underlying information, although Atmos has still not provided a detailed explanation, calculations, or workpapers with assumptions that support its proposed significant payroll increase. In contrast, I have a detailed workpaper with calculations and assumptions regarding the OAG payroll adjustment.

2) Mr. Densman's testimony can give the impression that Atmos' proposed payroll increase was limited to 3% base pay increases for October 2012 and October 2013, but in reality Atmos is seeking significant and unsubstantiated payroll expense increases of 17.31% for the combined base and forecasted test periods, an average increase of 8.66% for each period. In fact, Atmos' <u>Kentucky Direct</u> proposed payroll expense increase of 22.72%[14] for the combined base and forecasted test period is exceedingly unusual and significant. In comparison, OAG is proposing a <u>Kentucky Direct</u> payroll expense increase of 11.36% (one-half of Atmos' propose Kentucky Direct payroll increase) for the combined base and forecasted test periods, an average increase of 5.68% for each period. OAG's payroll adjustment is very reasonable and fair by most comparisons.

3) For combined <u>expensed and capitalized payroll labor, benefits, and taxes</u>[15] for **Kentucky Direct,** Atmos proposes a 20.69%[16] forecasted increase for the combined base and forecasted test year (10.35% per

[14] See Table BCO-4 and Revised Exhibit BCO-2, Revised Schedule A-7, page 2 of 2.
[15] The percentage increase for combined "total expensed and capitalized" payroll will be different than the percentage increase for just the "expensed" portion of payroll.
[16] See Table BCO-4 and Revised Exhibit BCO-2, Revised Schedule A-7, page 2 of 2.

year for the base and forecasted test periods) although the "actual" increases for the prior years is only -2.92% from 2011 to 2012, 2.65% from 2010 to 2011, 1.69% from 2009 to 2010, and 5.59% from 2008 to 2009.[17] Thus, Atmos' total forecasted increase for expensed and capitalized payroll is substantially greater than actual experience for prior years made available by Atmos, and it is also much larger than the claimed 3% annual base pay increase mentioned in Mr. Densman's testimony.

4) Regarding the prior bullet point related to payroll labor, benefits, and taxes for **Kentucky Direct** the 20.69% increase translates to a total increase in expensed and capitalized payroll of $3,267,806 from FYE 2012 through the end of the forecasted test period (an average increase of $1,633,903 for each of the base period and forecasted test period). In comparison, the actual historical payroll changes were an increase of $825,138 in 2009, $263,622 in 2010, $419,225 in 2011, and a <u>decrease</u> of $474,677 in 2012, and have never been larger than $825,138 (from 2008 to 2009) for the periods 2009 through 2012 made available by Atmos. Thus, Atmos average proposed forecasted payroll increase of about $1,633,903 for each of the base period and forecasted test period is already more than six times greater than the actual payroll increase of $263,622 in 2010; more than four times greater than the actual payroll increase of $419,225 in 2011, and significantly greater than the actual payroll decrease of $474,677 in 2012.

5) Atmos proposes all of the above significant increases in payroll and benefits, although its response to OAG 1-117 shows that the number of employees (209 employees) does not change from 2012 through the forecasted test period, so the proposed significant increases cannot be related to forecasted increases in employees.

6) For combined <u>expensed and capitalized payroll</u>, for **SSU and DGO,** Atmos proposes a 14% decrease ($1.5 million decrease) from actual 2012 through the partially forecasted <u>base period</u>, but this is somewhat deceiving because then Atmos proposes a 34% <u>increase</u> ($3.1 million increase) from the base period to the forecasted test period, which results in a total increase of $1.7 million (16%

[17] See Revised Exhibit BCO-2, Revised Schedule A-7, Page 2 of 2 (amounts are from Atmos' response to OAG 1-117, FR 16(13)(g), Schedule G-2, Witness: Mr. Densman.

increase) for the combined base and forecasted test periods.[18] Atmos does not explain and provide adequate supporting documentation for these unusual shifts and changes in amounts.

7) I do not specifically oppose Atmos' 3% base pay increase in October 2012,[19] and my adjustment allows for this increase and amounts above that. However, I am fundamentally opposed to Atmos' proposed base pay increase of 3% for October 2013, because this is not known and measurable, the number of related employees and turnover for October 2013 are not known or measurable, and offsetting possible efficiencies are not known and measurable at this time. Most importantly, I am opposed to the concept of allowing this 3% "merit" increase, because the merits of employees cannot be pre-determined or evaluated significantly in advance of October 2013 - - performance evaluations have not yet been performed for the twelve months ending October 2013 and it is not possible to determine each individual employee's performance. Atmos has not provided documentation that shows it has a specific amount of dollars set aside for merit pay in 2013, and even if it does, a true merit pay system is not defined by a bucket of dollars but should fluctuate each year based on actual employee's performance.

Q. SHOULD THE COMMISSION REJECT ATMOS' PAYROLL ADJUSTMENT DUE TO ITS FAILURE TO MEET A REASONABLE BURDEN OF PROOF?

A. Yes, Atmos has failed to adequately explain, document, and support its proposed significant payroll increase for the base and forecasted test periods.

[18] See Revised Exhibit BCO-2, Revised Schedule A-7, Page 2 of 2.
[19] I do not oppose the 3% base pay increase for October 2012, as long as this is limited strictly to the base pay increase and does not include other miscellaneous increases.

REVISED ADJUSTMENT OAG-5-BCO – REMOVE ONE-HALF OF INCENTIVE COMPENSATION COSTS FOR OFFICERS AND MANAGEMENT

Q. WILL YOU EXPLAIN WHY YOU ARE REVISING ADJUSTMENT OAG-5?

A. Yes. It was not clear to me from Atmos' response to OAG 2-61 Attachment 3 and OAG 2-58 Attachment 6[20] which amounts of LTIP/Restricted Stock Plan incentives were included in the forecasted test period, so in my original testimony I included both amounts from OAG 2-61 and OAG 2-58 to avoid understating this adjustment. Atmos has now clarified the amount of incentives included in the test period and I have reduced my adjustment accordingly, which I have also explained in my response to Atmos Question 38 and 42 (Atmos data requests to the OAG). The revised adjustment is a reduction of $582,228 in long-term incentive expense as shown at Revised Exhibit BCO-2, Revised Schedule A-8. In addition, I inadvertently failed to make the corresponding reduction to capitalized long-term incentives, and this adjustment is now reflected as a reduction of $391,201 to rate base. It is important to emphasize that the

[20] It was not clear if the 2012 amounts included in the response to OAG 2-61 Attachment 3 were also assumed to be the same amount for the forecasted test period and/or if these amounts were the same or different incentive amounts included in response to OAG 2-58 Attachment 6.

underlying reasons supporting my long-term incentive adjustment have not changed.

Q. WILL YOU SUMMARIZE ADJUSTMENT OAG-5-BCO (REVISED EXHIBIT BCO-2, SCHEDULE A-8)?

A. This expense adjustment of $582,228 (and corresponding adjustment to reduced capitalized long-term incentive costs by $391,201) removes one-half of the long-term incentive pay (direct and allocated) which are paid to officers and management because this compensation is awarded for meeting longer term shareholder-driven goals instead of goals that are related to ratepayer interests (such as incentives tied to goals related to customer satisfaction, safety, service quality, customer service, improved billing procedures, etc.). I am not proposing that Atmos withdraw these incentive plans or stop making these long-term incentive payments to employees, I am merely proposing that these amounts be removed for regulatory purposes, similar to the justification for other regulatory-proposed adjustments. I proposed this adjustment and the same rationale for long-term incentives, and it was adopted by the Public Service Commission of Maryland ("Maryland Commission") in a prior rate case, and the Maryland Commission has also adopted this same adjustment policy for other energy companies that it regulates. This adjustment is reasonable and will promote equitable treatment between ratepayers and shareholders.

Q. WILL YOU EXPLAIN IN MORE DETAIL HOW ATMOS' LONG-TERM INCENTIVE PLANS ARE TIED MORE CLOSELY TO LONGER TERM SHAREHOLDER-DRIVEN GOALS INSTEAD OF GOALS TIED TO RATEPAYER INTERESTS?

A. Yes. Atmos offers the following incentive plans:

1) Long-Term Incentive Plan ("LTIP") for the Management Committee, Corporate Officers, and Directors and Managers in pay grades 7 and above (OAG 2-61).
2) Management Incentive Plan ("MIP") for Management Committee, Corporate Officers, and Directors and Managers in pay grades 7 and above (OAG 2-60).
3) Variable Pay Plan ("VPP") for employees in grades 1 through 7 (OAG 2-58).

Although each of these long-term incentive plans vary to some degree among the employees to which they are offered or how they are paid, but each plan awards incentives based on a performance measure of the Earnings Per Share ("EPS"). In other words, Atmos' actual achieved EPS is measured against pre-established targets or criteria, and employees are paid an incentive award based on a sliding scale of how the Company performed against the EPS incentive goals or targets. The Company does not have to meet the "maximum" EPS target for employees to be paid an incentive award, but the higher the actual EPS (and the closer it is to the maximum EPS target), the greater the amount of incentive award that is paid to employees.

The EPS target is considered a "longer-term target/goal" even if it is awarded every year, and EPS is tied more closely to shareholder interests than it is to ratepayer interests. This is because shareholders will benefit more directly and significantly if and when a higher EPS is achieved via increased stock price, increased dividends, and long-term stability in all of these. All of the previously mentioned incentive plans promote achieving a higher EPS, and so shareholders will be the primary beneficiary of increased EPS over time.[21] In fact, any type of LTI target or goal that is primarily financial results-driven will provide more benefits to shareholders and the Maryland Commission supported this rationale in a prior decision removing 50% of LTI expense. I do agree that ratepayers will receive some residual benefit from increased EPS over time, but not to the extent that shareholders will benefit.

None of these incentive plans appear to have specific targets or goals that would be more customer/ratepayer focused and provide more direct benefits to ratepayers, such as improved customer satisfaction, improved

[21] Arguably, a shareholder that is also a ratepayer would stand to benefit also.

service quality, improved safety, improved customer service, improved billing procedures, and other customer-driven measures.

Because the incentive plans that I mentioned are focused more on shareholder-driven EPS goals (and financial results), I propose that the costs of long-term incentives be shared equally between shareholders and ratepayers, and that one-half of these incentives be disallowed or removed to below-the-line operations of Atmos.

Q. CAN YOU PROVIDE A CITE TO ANOTHER REGULATORY COMMISSION THAT HAS ADOPTED THE SAME ONE-HALF DISALLOWANCE (OR 50% SHARING) THAT YOU RECOMMEND IN THIS RATE CASE?

A. Yes, Washington Gas Light Company ("WGL") filed a rate case in Case No. 9267 before the Maryland Commission.[22] In that proceeding, I filed direct testimony proposing a 50% percent disallowance or sharing of the long-term incentive ("LTI") expense, and I subsequently amended by testimony to support a 75% exclusion of the LTI based on unique circumstances in that case. The Commission adopted a 50% disallowance of the LTI and stated that it agreed with the Hearing Examiner's decision

[22] *In the Matter of the Application of the Washington Gas Light Company for Authority to Increase its Existing Rates and Charges and to Revise its Terms and Conditions for Gas Service*, before the Maryland Commission, Case No. 9267, Order No. 84475, issued November 14, 2011 ("WGL rate case").

in the prior WGL rate case to disallow 50% of the LTI, when the Hearing Examiner stated:

> it is unreasonable for ratepayers to fund the total increase in incentive compensation in this instance, which appears to be a result of the Company reaching a rate of return threshold, and due to an accounting change for stock options which are primarily tied to the Company's financial goals.[23]

The Maryland Commission's Order in the WGL rate case also stated the following regarding the 50% disallowance of the LTI:

> Based upon the record in this proceeding that LTI pay is based solely upon shareholder interests, the Commission concludes that it is appropriate to allow recovery of only one-half of LTI compensation in cost of service, which is consistent with our decision in WGL's last base rate case. Therefore, we exclude $1,201,138 of LTI pay for total reduction in incentive compensation of $1,762,398 ($1,201,138 + $561,260) from the Company's operating expenses, which translates into a net of tax increase in operating income of $1,051,050.[24]

Q. ARE YOU AWARE OF ANY UNIQUE REASONS FOR NOT ADOPTING THE 50% DISALLOWANCE IN THIS RATE CASE?

A. No.

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[23] *Id.* WGL rate case, page 28.
[24] *Id.* WGL rate case, page 30.

ADJUSTMENT OAG-6-BCO - REMOVE INCREASED COSTS OF "SINGLE GO-LIVE" CSS IMPLEMENTATION DECISION, UNTIL EFFICIENCES ARE REFLECTED IN RATE CASES IN FUTURE YEARS

Q. WILL YOU SUMMARIZE ADJUSTMENT OAG-6-BCO (EXHIBIT BCO-2, SCHEDULE A-9)?

A. This adjustment reflects cost savings due to the implementation of the new CSS, including cost savings previously reported to the Board of Directors by Atmos. This adjustment reflects cost savings via a reduction in operating expenses of **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** and via an adjustment to reduce CSS capital costs **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL.**

Q. WILL YOU EXPLAIN ATMOS' DECISION TO CHANGE ITS CSS IMPLEMENTATION APPROACH?

A. Mr. Martin's testimony briefly addresses the new Customer Service System (CSS), but does not explain Atmos' decision to change its implementation approach for the CSS. Atmos' responses to various OAG data requests indicates that the Company changed its deployment strategy from using a <u>two-stage</u> "go-live" (implementation) to a <u>single stage</u> go-live implementation of the new CSS. Atmos' response to OAG 1-

97 states that the original cost of a two-stage CSS implementation was estimated at $64 million (total system, not Kentucky allocated) and this increased by about $8 million, to a cost estimate of $72 million with the decision to adopt a single stage CSS implementation. However, the final actual costs of the single stage implementation increased by about $6.9 million, to an amount of $78.9 million due to the addition of internal resources for testing the system prior to final go-live implementation.

Q. WHY ARE YOU PROPOSING ADJUSTMENTS RELATED TO THE CSS IMPLEMENTATION?

A. I am proposing this two-part adjustment for two primary reasons:

1) Cost Savings Originally Identified by Atmos but Not Included in this Rate Case - To reflect estimated efficiencies and cost savings related to the new CSS system based on estimates originally provided at Board of Directors meetings, and which have not been included in this rate case by Atmos (although other arbitrary and unproven cost increases have been included in this rate case).

2) Share Increased Costs from 2-Stage to Single-Stage Approach - Atmos must have anticipated certain quantitative and qualitative benefits related to the implementation under the single stage approach (versus the 2-stage approach), and these benefits should be shared with ratepayers (thus, the 50% share of the excess costs related to single-stage implementation).

Q. HOW DID YOU DETERMINE THE FIRST PART OF YOUR ADJUSTMENT TO CSS?

A. OAG 1-97 asked Atmos to provide forecasted costs and efficiencies of CSS, and to compare original forecasted costs to actual costs and explain the reasons for variances. Atmos' response provided Confidential Attachment 1 as a copy of a presentation made to the Board of Directors on August 4, 2010 which showed total annual estimated O&M savings related to CSS of **BEGIN CONFIDENTIAL** [redacted] for 2013, [redacted] for 2014, and [redacted] for 2015. I used the 2015 savings of [redacted] **END CONFIDENTIAL** and calculated a ratio of this savings to Atmos' original capital spend of $47 million, and then I applied this ratio to Atmos' updated capital spend of $78.9 million. This calculation is shown at Exhibit BCO-2.

Q. HOW DID YOU DETERMINE THE SECOND PART OF YOUR ADJUSTMENT FOR CSS SAVINGS?

A. I am proposing to at least temporarily remove costs related to one-half of the difference between the original 2-stage CSS costs of $64 million and the final actual single-stage CSS costs of $78.9 million, so the total cost increase of $14.9 million will be cut in half to $7.45 million (this amount also approximates the $8 million increase in original estimated costs from the 2-stage CSS costs of $64 million to the single-stage CSS costs of $72 million, and this rationale can also be used regarding this adjustment). In addition to removing the capital costs of about $7.45 million, I am also removing the related depreciation expense on these capital costs. On an Atmos Kentucky allocated basis, this adjustment will temporarily reduce CSS capital costs **BEGIN CONFIDENTIAL** [redacted] and temporarily reduce depreciation expense [redacted] **END CONFIDENTIAL.**

ADJUSTMENT OAG-7-BCO - REMOVE NET OPERATING LOSS CARRYFOWARD TAX BENEFIT AMOUNT FROM ACCUMULATED DEFERRED TAXES ("NOLC ADIT")

Q. WILL YOU SUMMARIZE ADJUSTMENT OAG-7-BCO (EXHIBIT BCO-2, SCHEDULE A-10)?

A. I have reduced rate base by an amount of $22,221,329 related to a NOLC ADIT tax benefit which has the impact of increasing rate base for the accumulated deferred tax impact calculated on book-tax timing differences that cause a loss on the income tax return. I was only able to calculate an estimate of this amount, and my adjustment may be understated. This amount should be removed from rate base and will not cause any tax normalization violations. If there is substantive disagreement on this issue, then I recommend that Atmos seek a private letter ruling with the Internal Revenue Service on this issue to resolve the matter.

Q. WHAT IS A NET OPERATING LOSS CARRYFORWARD ACCUMULATED DEFERRED INCOME TAX BALANCE "NOLC ADIT"?

A. I will use the term NOLC ADIT to refer to the accumulated deferred tax impact (which is the "debit" amount netted with the typical "credit" amounts included in the accumulated deferred income tax account) recorded on tax timing differences that are causing a loss for income tax purposes, and this primarily consists of bonus depreciation, capitalized overheads, and repair allowances. I am most concerned with removing the NOLC created by tax bonus depreciation that is causing an income tax loss. Typically accumulated deferred income taxes include the tax impact of depreciation timing differences for income taxes, and this is recorded as a credit amount and is used as an offset to rate base. I do not have any concerns regarding these amounts. However, a NOLC is the opposite, it is the deferred tax impact recorded mostly due to bonus depreciation timing differences (and other timing differences) that are causing a loss for income tax purposes. This amount is included as debit (or "deferred tax asset") as an offset to the typical credit balance in the accumulated deferred income tax account and it causes an increase in rate base.

Q. HOW DID YOU IDENTIFY THE NOLC ADIT ON ATMOS' BOOKS?

A. OAG 2-78 referred to Staff 1-47 and asked Atmos to identify all NOLC ADIT amounts included in this rate case by account and how it has been treated in this rate case. Atmos' response states that it has generated tax losses on all tax returns for tax years ended September 30, 2008 through September 30, 2012, and some of these net operating losses have been carried back with the remainder being carried forward, including amounts for September 30, 2010 through September 30, 2012. Atmos states that it included a NOLC ADIT through the forecasted test period March 31, 2013, in this rate case. Atmos' response to AG 2-78 refers to the responses of OAG 1-47 and Staff 1-59 as including workpapers and amounts showing the NOLC ADIT in accounts 1900 and 2820. However, Atmos did not specifically provide the Kentucky portion of NOLC ADIT[25] included in the forecasted test period and did not specifically explain which amounts from the workpapers represent the NOLC ADIT amounts. I have prepared a workpaper and calculation included at Exhibit BCO-2

[25] The response to OAG 2-78 did identify a NOLC ADIT amount of $340,724,523 prior to any allocation.

related to my adjustment to remove the NOLC ADIT. I used my best efforts to determine the NOLC ADIT amounts from the cited workpapers and data requests, but I may have understated the amount. I am removing an estimated NOLC ADIT of $22,221, 329 from this rate case, and this will cause rate base to decrease by this amount.

Q. DID YOU REMOVE OR REDUCE INCOME TAX EXPENSES ALSO?

A. No, although an argument can be made for reducing income tax expense as part of the NOLC ADIT adjustment. I am only removing the NOLC ADIT from rate base and I am not proposing any adjustments to income tax expense.

Some utilities will argue that any adjustments to remove the NOLC ADIT or to reduce income tax expense will cause a tax normalization violation of the tax code. However, in another rate case where I participated on behalf of the Kentucky Office of Attorney General, Big Rivers Electric Corporation ("BREC") had a NOLC ADIT and volunteered to reduce its state and federal income tax to zero.[26] In the BREC rate case, my direct testimony explains that BREC has a NOLC ADIT of $30.1 million, and because it can use this amount to carry-forward and offset against future

[26] *In the Matter of: Application of Big Rivers Electric Corporation for a General Adjustment in Rates,* Commonwealth of Kentucky, Before the Public Service Commission of Kentucky, Case No. 2012-00535.

federal and state income taxes, BREC did not include any amounts for federal or state income tax expense in its rate case because the Company will not incur or pay any federal or state income taxes for the foreseeable future.[27] Thus, I do not believe that removing a NOLC ADIT or reducing income tax expense related to this same issue will cause a tax normalization adjustment because I do not think that BREC would voluntarily put itself in a position to be in violation of the tax code.

Q. WILL A TAX NORMALIZATION VIOLATION OCCUR IF A REGULATORY ADJUSTMENT IS MADE TO REMOVE THE NOLC ADIT IN A RATE CASE?

A. No. A tax normalization violation would typically occur if a company failed to be compliant in recording deferred income taxes on depreciation book-tax timing differences in some manner under the conventional method of recording deferred income taxes, a tax normalization violation in this sense only relates to "depreciation" related timing differences and not to any other tax timing difference or issue. However, a tax normalization violation will not result from removing the NOLC ADIT in a rate case. Internal Revenue Code §168(i)(9) and Treasury Regulations §1.167(l)-1(h)(1)(b)(iii) and §1.167(l)-1(h)(6)(i) do not specifically require a

[27] Bion C. Ostrander, Direct Testimony, Case No. 2012-00535, May 24, 2013, p. 71, lines 2-16.

NOLC ADIT to be included in rate base in a rate case and do not state that the failure to include a NOLC in rate base for regulatory purposes is a tax normalization violation. Treasury Regulation §1.167(l)-1(h)(1)(b)(iii) makes limited reference to a "net operating loss carryover", but then merely indicates that the "amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director." To the best of my knowledge, Atmos has not sought or received any direction from the district director regarding the treatment of a NOLC ADIT. Also, Treasury Regulation §1.167(l)-1(h)(6)(i), refers to the maximum amount of the deferred tax reserve that is to be "excluded from the rate base" (or to be included as no-cost capital) and this applies to the typical recording of the accumulated deferred income tax as a liability amount, but this section of Treasury Regulation is not applicable to the NOLC ADIT which is "included in the rate base" (and is not excluded from rate like the typical credit balance accumulated deferred income taxes).

Furthermore, Treasury Regulation §1.167(l)-1(a)(1) only relates to federal tax normalization and does not require tax normalization of book-tax timing differences for state purposes. Therefore, at the very minimum, Atmos' inclusion of an NOLC ADIT for state purposes can be removed from this rate case without any tax normalization based on Treasury Regulations.[28]

Q. **ARE YOU AWARE OF ANY SINGLE CASE WHERE A STATE UTILITY REGULATOR'S FAILURE TO INCLUDE A NOLC ADIT IN RATE BASE CAUSED A TAX NORMALIZATION VIOLATION FOR A COMPANY?**

A. No.

Q. **ALTHOUGH YOU ARE NOT AWARE OF ANY ACTUAL TAX NORMALIZATION VIOLATIONS THAT HAVE OCCURRED RELATED TO A NOLC ADIT, HAVE REGULATORY AGENCIES COME DOWN ON BOTH SIDES OF THIS ISSUE?**

A. Yes, there are citations both directions, some state regulatory agencies have removed NOLC ADIT from rate base in a rate case and some have required inclusion of the NOLC ADIT in rate base.

[28] I have not fully researched Kentucky state tax law regarding NOLC ADIT, but it is possible that state tax makes it appropriate to record a NOLC ADIT for "state" income tax purposes.

Q. CAN YOU EXPLAIN IN MORE DETAIL THE WEST VIRGINIA COMMISSION'S DECISION IN THE MOUNTAINEER GAS CASE TO REMOVE NOLC FROM RATE BASE, AND ITS DETERMINATION THAT THIS DOES NOT CAUSE A TAX NORMALIZATION VIOLATION?

A. Yes. The West Virginia Commission denied Mountaineer Gas' proposal to include a NOLC in its rate base in three consecutive orders (including the original order and two subsequent requests for reconsideration) dated October 31, 2012, February 11, 2013, and April 9, 2013. In response to the two reconsideration requests the West Virginia Commission re-affirmed its original position and stated that a NOLC can be excluded from rate base without causing a tax normalization violation. This case is current and applicable to the same issues in this Atmos case.

Mountaineer Gas included net operating loss carryforwards (identified as "NOLs") as an increase to its rate base and made some of the same arguments as other utilities have made by stating that failure to include these amounts in rate base would cause a tax normalization violation. In its original October 31, 2012 Order, the West Virginia Commission stated that Mountaineer could not offset the NOLs against the ADIT and reduce rate base:[29]

> The Commission has thoroughly considered this issue and will deny Mountaineer's proposed $11.4 million reduction in its plant-related ADIT liability balances. The treatment of the $11.440 million reduction proposed by Mountaineer effectively creates an offsetting regulatory asset to the ADIT balance which the Commission specifically rejected in the January 17, 2012 Order in Bluefield, Case No. 11-0410-G-42T.[30]

Also, the West Virginia Commission stated:

> Recording the future federal income tax liability related to temporary depreciation timing differences in the year in which the timing differences occur is not incorrect nor does it in any way violate the tax statutes or IRS regulations.[31]

In its subsequent February 11, 2013, Order issued on reconsideration, the West Virginia Commission re-affirmed its previous position and stated:[32]

> 1. The Commission's decision regarding ADITs and the Minimum Adjustment, as explained in the November 2012 Order, was supported by the record in this case, is reasonable, and was fully and adequately addressed in that Order.

[29] West Virginia Commission, page 17, dated October 31, 2012. The West Virginia Commission does indicate that it will not adopt "normalization accounting" for "state" income tax purposes, but it does not indicate that its decision to disallow NOLs is a violation of "federal" tax rules regarding normalization.
[30] Id., page 16.
[31] Id., page 16 and page 54, Conclusion of Law, item 12.
[32] West Virginia Commission, page 8, Conclusions of Law, items 1 and 2, Order dated February 11, 2013.

> 2. The Commission <u>is not persuaded by the Mountaineer arguments that its treatment of ADITs and current deferred income tax expense used in setting the Company rates in the November 2012 Order is unreasonable or creates a normalization violation.</u> (Emphasis added).

Finally, on April 9, 2013, the West Virginia Commission issued is latest and third order, responding to the second reconsideration request of Mountaineer Gas. Again, the West Virginia Commission reaffirmed the decision to remove the NOL from rate base and stated that this does not cause a tax normalization violation.[33]

Q. CAN YOU DISCUSS THE PLR ISSUE IN THE MOUNTAINEER GAS CASE?

A. Mountaineer Gas' second reconsideration request asked the West Virginia Commission to order the utility to get a Private Letter Ruling ("PLR"), but the Commission declined, and said that the decision to seek a PLR is one to be made by Mountaineer.[34]

[33] West Virginia Commission, page 9, Conclusions of Law, items 1, 2, 3, 4, 5, 6 and 7, Order dated April 9, 2013.
[34] West Virginia Commission, Conclusions of Law, p. 8, Order dated February 11, 2013.

Q. IF THERE IS SUBSTANTIVE DISAGREEMENT ON THE NOLC ADIT ISSUE WITH ATMOS, WOULD YOU RECOMMEND THAT ATMOS OBTAIN A PRIVATE LETTER RULING TO RESOLVE THIS ISSUE?

A. Yes, I believe a private letter ruling may be the only reasonable manner to resolve this issue between parties with significant differences of opinion.

Q. IS ATMOS' FORECASTED TAX LOSS THAT IS USED TO CALCULATE A NOLC ADIT FOR 2013 CONSIDERED TO BE "KNOWN AND MEASURABLE"?

A. No. Atmos admits that it included a projected NOLC ADIT in rate base for at least part of 2013 (and perhaps through 2014), although I was not able to determine this precise amount. A NOLC ADIT only results from an income tax loss, and it is not possible to know if Atmos will have a tax loss for years 2013 and 2014 until it finalizes and formally files its federal income tax return. A company cannot deduct accelerated tax depreciation on its books until the year of that depreciation and any attempt to take the benefit of tax depreciation in advance would constitute a tax normalization violation. Furthermore, a company cannot be subject to a tax normalization violation for not seeking recovery of NOLC ADIT's in forecasted test periods in rate cases, and this is because a tax loss cannot be reasonably known and measured until the actual income tax return is filed.

Q. WHAT ARE YOUR CONCLUSIONS REGARDING THE NOLC ADIT ISSUE?

A. All NOLC ADIT balances should be removed from this rate case and this will not cause any tax normalization violation, and there is no proof that this type of regulatory adjustment has ever caused a tax normalization violation in any rate case.

ADJUSTMENT OAG-8-BCO – REDUCE BAD DEBT EXPENSE FOR ATMOS' ERROR

Q. WILL YOU SUMMARIZE ADJUSTMENT OAG-8-BCO?

A. This adjustment reduces bad debt expense by $25,048 for an error admitted by Atmos in its response to OAG 1-152.

Q. DO YOU SUPPORT ANY INCREASES IN RATE CASE EXPENSE BEYOND THE AMOUNT INCLUDED IN ATMOS' ORIGINAL APPLICATION?

A. No. I believe the amount of rate case amortization expense that is the lesser of actual amortization expense or the estimated three-year amortization expense of $105,667 (included in the original Application) is adequate.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.