COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

ATTORNEY GENERAL'S POST-HEARING BRIEF

PUBLIC REDACTED VERSION

Respectfully submitted,
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Comes now the intervenor, the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention, and states as follows for his post-hearing brief in the above-styled matter.

Introduction

Atmos Energy Corporation ("Atmos") is a multi-state industry-owned natural gas utility serving approximately 173,200 customers throughout Western and Central Kentucky.[1] Of those customers, residential customers account for approximately 153,900 of Atmos' total customer base.[2] On 13 May 2013, Atmos filed an Application for an Adjustment of Rates and Tariff Modifications, seeking approval from the Public Service Commission ("the Commission") for $13,367,575 in additional revenues representing a 22.5%[3] increase or over $50 per year/$4.50 per monthly bill for the average residential customer.[4] Atmos utilized a forward-looking test period corresponding to the twelve month period December 1, 2013 through November 30,

[1] Direct Testimony of Martin, page 7, lines 5-6.
[2] Direct Testimony of Martin, page 7, lines 6-7.
[3] Direct Testimony of Watkins, page 45, line 7 (Table 9).
[4] Direct Testimony of Martin, page 9, lines 12-14.

2014.[5] The base period is August 2012 through July 2013,[6] 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.[7]

Pursuant to KRS 367.150(8), the Attorney General of the Commonwealth of Kentucky ("AG") intervened on behalf of Atmos ratepayers. The Commission also granted Stand Energy Corporation "full intervention limited to participation on the issues of Atmos Energy's transportation threshold levels and any other matters related thereto, but not whether a Pilot Program for Schools or enhanced Standards of Conduct should be added."[8] The Commission held a public hearing on 23 January 2014.

After multiple rounds of data requests by the AG and Commission staff revealing certain errors in Atmos' revenue calculation, Atmos adjusted its revenue request downward by $76,310 for an adjusted revenue request of $13,291,265.[9] Despite this adjustment, Atmos fails to meet its burden of proof pursuant to KRS 278.190(3) to demonstrate that the revenue increase it proposes will result in fair, just and reasonable rates. Therefore, and as explained in the testimony filed by the AG and summarized herein, the AG recommends adjustments totaling $9,591,256 resulting in a revenue increase not to exceed $3,700,009.[10]

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[5] Direct Testimony of Densman, page 16, lines 7-9.
[6] Direct Testimony of Densman, page 16, lines 5-6.
[7] Direct Testimony of Ostrander, page 6, lines 11-15.
[8] Order entered 3 September 2013.
[9] Rebuttal Testimony of Martin, pages 4, line 11 to page 5, line 5.
[10] *See* Appendix A, Table 1, line 6.

Statement Of The Case And Procedural History

The procedural history of this matter, which may be distinguished from nearly every rate case that has been filed by Atmos since 1999, is most relevant to the AG's full litigation of this matter as well as his final recommendation.

On 13 May 2013, Atmos filed its Application for an Adjustment of Rates and Tariff Modifications based on its election to use electronic filing procedures.[11] On 26 June 2013, after three (3) additional filings by Atmos in an effort to cure application deficiencies,[12] the Commission entered a letter indicating that the "case now meets the minimum filing requirements."[13] The AG sought intervention on 2 July 2013, and notified the Commission of his consent to follow the electronic filing procedures. Initial Discovery Requests ("DRs") by the AG and Commission Staff were issued on 14 August 2013. Atmos filed its responses to the DRs on the 11 September 2013 deadline. However, due to substantial errors by Atmos regarding the Commission's relevant electronic filing procedures,[14] portions of the filed responses were unable to be reviewed and analyzed by the AG before the 25 September 2013 deadline, at which time the AG was to file his supplemental discovery requests.

Moreover, other portions of the Atmos responses were objectively unresponsive and/or incomplete. The AG attempted to resolve the discovery issues informally and

[11] *See* Atmos' Notice Of Election Of Use Of Electronic Filing Procedures, Filed 29 April 2013.
[12] *See,* Atmos Energy Corporations Response to Deficiency Filing Letter dated May 28, 2013 and Motion for Deviation, Filed 30 May 2013; Atmos Energy Corporation Revised Response to Deficiency Letter and Motion for Deviation, Filed 3 June 2013; Atmos Energy Corporations Response to June 24, 2013 Order, Filed 26 June 2013.
[13] 26 June 2013 Deficiency Cured Letter.
[14] See 807 KAR 5:001(8).

in good faith with Atmos, however, the AG was forced to file his second round of DRs ***before*** he had received many of the responses to his initial discovery. Atmos responded to some of the AG's concerns regarding Atmos' responses to the initial DRs with Supplemental Responses to AG First Data Requests filed 18, 20 and 24 September 2013. Atmos filed its responses to the AG and PSC's supplemental data requests on 25 September 2013. On 26 September 2013 Atmos filed additional responses to the AG's first DRs and additional responses to PSC's first and second DRs. Direct testimony of the AG's witnesses, DRs to the AG from Atmos and the Commission, and responses of the AG to the DRs were all filed timely between 9 October 2013 and 6 November 2013.[15]

By Order of the Commission dated 30 October 2013 a Hearing was scheduled for 3 December 2013. On 15 November 2013 Atmos filed supplemental responses to PSC's first and Second DRs as well as the AG's initial DRs. The information Atmos provided on this date in its delayed response to the AG's initial discovery requests was essential to the AG's analysis of Atmos' revenue requirement and the preparation of the AG's case. ***This essential information was not provided to the AG until four (4) months after it had been requested and only two (2) weeks before the Hearing was scheduled to commence.*** As a result of Atmos' inability to timely respond to discovery, and as a result of substantive information revealed only weeks before the hearing, the AG filed supplemental and Corrected Testimony of Bion Ostrander on 18 November 2013. The purpose of this testimony was to update Mr. Ostrander's calculations with information

[15] Direct Testimony of Ostrander and Watkins, filed 9 October 2013; PSC and Atmos DRs filed to AG on 23 October 2013; AG responses to DRs filed 6 November 2013.

the AG did not possess when Mr. Ostrander filed his original direct testimony on 9 October 2013. The revised testimony and attached schedules could have been updated and corrected during the Hearing, as is frequently and commonly done before the Commission, but the AG, again operating in good faith, provided the applicant, Atmos, and the Commission a full and fair opportunity to review the updated testimony prior to the hearing. Further, the AG believed filing the Supplemental and Corrected Testimony would ensure judicious use of the Commission's time during the Hearing.

On 19 November 2013 Atmos filed rebuttal testimony, as the procedural schedule allowed. However, the rebuttal testimony contained 90 pages of spreadsheets in portable document format ("pdf."). Despite a standing and ongoing request by the AG, as well as the ordinary practice and procedure, that all spreadsheets be provided in their native, original and functional format, with cells and data intact, as of 21 November 2013 - a mere five business days before the Hearing was scheduled to commence - Atmos still had not produced the original Excel version of those spreadsheets. The Excel files were filed with the Commission and supplied to the AG on 22 November 2013. Due to the inability of Atmos to correctly file its rebuttal testimony, as well as Atmos' inability or unwillingness to timely produce requested information and documents, the AG had no choice but to seek an extension of time - despite his strong preference and practice to maintain all procedural deadlines.

On 27 November 2013 the Commission granted the continuance the AG was forced to request and granted both parties the opportunity to further analyze any and

all new information. The Hearing was rescheduled for 23 January 2014 and took place on that date. Despite the procedural roadblocks created by the applicant, the Hearing took only one (1) day to complete. The delay in commencing the Hearing resulted in the expiration of the statutory suspension period under KRS 278.190(2).[16] Therefore, Atmos placed the proposed rates into effect on 24 January 2014, subject to refund after a final Order from the Commission.[17] The Commission ordered the filing of Post-Hearing Briefs by 25 February, 2014.[18]

ARGUMENT

1) Atmos has failed to meet its burden to demonstrate that the assumptions made using a future test year are reasonable.

Atmos utilized a forward-looking test period corresponding to the twelve month period December 1, 2013 through November 30, 2014.[19] The base period is August 2012 through July 2013[20], which includes seven months of actual historical data for the period August to February 2013 and five months of estimated data for the period from March 2013 to July 2013.[21] KRS 278.192 permits a utility to utilize a forward-looking test

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[16] KRS 278.190(2) in relevant part states "the Commission may… defer the use of the rate, charge, classification, or service, but not for a longer period than…six (6) months if a forward looking test period is used."
[17] Atmos Energy Corporations Notice of Intent to Implement Rates, filed 22 January 2014; Order entered 28 January 2014.
[18] VT 19:48:09-19:50:12.
[19] Direct Testimony of Densman, page 16, lines 7-9.
[20] Direct Testimony of Densman, page 16, lines 5-6.
[21] Direct Testimony of Ostrander page 6, lines 11-15.

period, also known as a future test year ("FTY") for the purpose of justifying the reasonableness of a proposed general increase in rates."[22]

However, the statutory leave to use a FTY does not obviate a utility's "burden of proof to show that the increased rate or charge is just and reasonable shall be upon the utility."[23] Further, the use of a FTY imposes additional challenges on the applicant, as well as the Commission and intervenors. In a recent report from the National Regulatory Research Institute ("NRRI"), the authors explained: "the merits of an FTY rest on the details of whether the forecasts (1) reflect prudent utility management and (2) contain a minimal margin of error. After all... an FTY could easily take money away from utility customers and give it to the utility and its shareholders."[24] The AG's witness, Mr. Ostrander, describes this difficulty for the Commission; whereas, the AG and any other independent evaluator, who 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."[25] The NRRI report goes on to explain this dilemma:

> Although the utility may have the burden to demonstrate the reasonableness of its predictions, any proposed adjustments by other

[22] KRS 278.192 states in relevant part: "For the purpose of justifying the reasonableness of a proposed general increase in rates, the commission shall allow a utility to utilize either an historical test period of twelve (12) consecutive calendar months, or a forward looking test period corresponding to the first twelve (12) consecutive calendar months the proposed increase would be in effect..."
[23] KRS 278.190(3).
[24] *Future Test Years: Challenges Posed for State Utility Commissions*, National Regulatory Research Institute (NRRI) Briefing Paper No. 13-08, July 2013 at v.
[25] Supplemental and Corrected Testimony of Ostrander, page 8, lines 14-17.

> parties would require an evaluation showing the predictions' shortcomings. The utility has a big advantage over other parties in knowing its prudent costs. It is hard for commission staff and interveners to either (1) show that the utility's costs are excessive or (2) produce independent forecasts that reflect efficient utility management.[26]

An applicant has a high bar to clear in order to prove that the proposed rates are fair, just and reasonable, based on the Company's own assumptions and forecasts, which are unable to be recreated by either the AG or the Commission.

Atmos enjoys no presumption of reasonableness, rather the opposite is true. As the Commission has stated in response to an NRRI questionnaire "Utilities must demonstrate the reasonableness of their forecasts."[27] Unfortunately, it seems that management of Atmos Kentucky/Midwest Division is either unaware of this burden or unwilling to accept it. When asked on four (4) separate occasions at the Hearing whether Atmos' Vice President of Rates and Regulatory Affairs for the Kentucky/Mid-States Division accepts that there is a burden of reasonableness brought with filing a rate case using a FTY, his counsel objected to a straight-forward yes or no response, and the Atmos witness refused to answer.[28] However, the same witness did recognize the following: "I believe that the company needs to justify the numbers that they are seeking."[29] Nonetheless, Atmos has not met this burden.[30] Rather, as demonstrated by

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[26] *Future Test Years: Challenges Posed for State Utility Commissions*, National Regulatory Research Institute (NRRI) Briefing Paper No. 13-08, July 2013 at 19.
[27] NRRI's Future Test Years: Evidence from State Utility Commissions, Report No. 13-10, October 2013.
[28] January 23, 2014 Video Transcript (M. Martin), 10:47:55-10:49:39.
[29] VT (M. Martin) 10:49:30-10:49:39.
[30] *See* KRS 278.190 "At any hearing involving the rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the utility…"; *See also* Energy Regulatory Commission v. Kentucky Power Co., Ky.App., 605 S.W.2d 46, 50 (1980). (At such

the expert testimony sponsored by the Attorney General and the evidence presented during the hearing, Atmos has not demonstrated that its application for over $13 million in new revenue using a FTY will result in rates that are fair, just and reasonable.

2) Special Contracts that are discounted below tariff rates are unreasonable.

Atmos had no less than seven (7) opportunities to provide the AG and the Commission with its analysis regarding the need for entering into special contracts in order to prevent certain industrial customers from bypassing Atmos' distribution system and directly connecting to an intrastate pipeline.[31] Atmos completely failed to ever produce any evidence supporting the need for the special contracts. Instead, Atmos' Director of Rates and Regulatory Affairs testified that Western Kentucky Gas – an Atmos predecessor – did some analysis when they first began to sign onto special contracts with industrial customers, but that analysis cannot now be located.[32] To summarize, Atmos has conducted exactly zero analysis of its own, and the only analysis that has ever been done to suggest that these special contract customers are indeed a threat to bypass Atmos cannot be found.[33]

As Mr. Watkins succinctly put it: "the issue is should captive rate payers fund these costs because there is a justifiable threat of bypass? And again, no evidence in this

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hearing and through the Commission proceeding, the municipal utility seeking the rate adjustment bears the burden of showing that the proposed adjustment is reasonable.)

[31] 1. Application and supporting Testimony; 2. Exhibit 3: AG 1-212(g) (specifically requesting analysis undertaken by Atmos to support necessity of tariff rate lower than the full tariff rate for special contracts customers); 3.Exhibit 1: AG 2-87; 4. Exhibit 2: AG 2-88; 5. Rebuttal testimony of Smith; 6. Supplemental testimony of Smith; 7. Cross examination of Smith, VT 17:32:49-18:05:50.

[32] Rebuttal Testimony of Smith, page 4, lines 3-10.

[33] VT (G. Smith) 17:52:15-17:52:42.

case or any other case has come about that there is any threat of bypass. I'm not saying there's not, I'm just saying the burden is on [the Company] if you want captive ratepayers to fund that discount."[34] Mr. Watkins is entirely correct -- the burden is on Atmos to demonstrate that these contracts are reasonable and that it is reasonable to shift the expense of these contracts onto the ratepayers that pay full tariff rates. The special contract customers, meanwhile, enjoy discounts of 81% from full tariff rates.[35] In light of Atmos' inability to produce any shred of evidence that these contracts are reasonable, Atmos has not demonstrated the rates are reasonable.

Not only did Atmos fail to produce financial analysis of its justification of the threat of bypass; Atmos was incapable of demonstrating any special contract customer had the physical ability to bypass because of the lack of reasonable proximity to an interstate pipeline. Indeed the AG asked Atmos in discovery to produce maps that Atmos had showing the location of the special contract customers and their proximity to interstate pipelines.[36] Atmos did produce maps, nearly a month after Atmos' response to the AGs first round of DRs was due.[37] While Atmos originally stated that the maps were in use by Atmos at the time they were produced to the AG,[38] that

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[34] VT (G. Watkins) 19:29:12-19:29:34.
[35] VT (G.Watkins) 19:17:18-19:17:38; Rebuttal Testimony of Watkins, page 33, lines 4-7 ("The discounts associated with these customers total $6,109,525 and on average, represent a discount from Commission-approved full tariff Industrial Transportation rates of 80.6% (i.e., the average discount is 80.6% below full tariff rates).")
[36] AG 1-212.
[37] *See* 28 July 2013 scheduling Order detailing 28 August 2013 deadline for Atmos to file responses to requests for information; Supplemental Responses to AG's First Data Requests, Filed 20 September 2013.
[38] Atmos Supplemental Response to AG 1-212(j). ("The Company has used its existing maps to attempt to satisfy this request.")

statement was not actually correct.[39] After the Hearing, Atmos confirmed that the maps were produced as a result of the AG's request.[40] Even if the maps had been in use prior to the AG's request, Atmos witness Mr. Martin confirmed during the Hearing that the maps were of such poor quality as to prevent any useful information from being discovered regarding the physical and logistical possibility of a special contract customer connecting directly to the nearest interstate pipeline.[41] Atmos was unable to produce any credible evidence that any of the special contract customers possess the logistical, financial, or physical capability to bypass Atmos.

Atmos has seventeen (17) contracts with sixteen (16) different customers providing discounted rates.[42] As was confirmed at the Hearing, some of the special contracts customers are as much as [redacted] miles from the nearest interstate pipeline.[43] Yet, Atmos can produce not a single shred of evidence that this customer is indeed a threat to bypass Atmos. The contract granting the customer that is [redacted] miles from the nearest pipeline below-tariff rates is [redacted] years old and has never been updated.[44] Importantly, this is not even the oldest contract Atmos still has in effect with special contract customers. Considering the age of the contracts and the fact that Atmos doesn't have any analysis regarding the need

[39] AG Exhibit 3, page 303, paragraph J ("The Company has used its existing maps to attempt to satisfy this request.").
[40] Hearing DR 1-02 ("The special contracts maps provided by Atmos Energy were specifically created in September 2013 in response to data requests for this hearing.")
[41] VT (M. Martin) 11:03:30-11:15:04. (Confidential)
[42] AG Exhibit 4; Supplemental Schedule GAW-1. (Confidential)
[43] *Id.* line D. (Confidential)
[44] *Id.* line D. (Confidential)

for these contracts and the associated discounts begs the question whether the contracts are unreasonable.

The special contracts unjustifiably provide below-tariff rates to select industrial customers.[45] Nearly all of the contracts are more than a decade old.[46] None of these contracts have been renegotiated since the year 2000.[47] As the perfect summation of Atmos' attitude towards these contracts, it took Atmos over four months just to **locate** the contracts in its own files.[48] Atmos has provided no evidence that these customers are legitimate threats to bypass Atmos.

In the interest of fairness and to recognize some benefit to attracting and retaining industrial customers, the AG has proposed that 50% of the cost of these special contracts be borne by either the special contract customers or Atmos shareholders and 50% be borne by the rate payers, without adjusting rate base. It is possible that some of the special contract customers are a legitimate threat to bypass Atmos, but it is likely that some of these contracts are unreasonable and some of the special contract customers are not legitimate threats to bypass Atmos.[49] The AG also recommends that the Commission require analysis to determine whether the special

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[45] VT (G.Watkins) 19:17:18-19:17:38; Rebuttal Testimony of Watkins, page 33, lines 4-7.
[46] AG Exhibit 4.
[47] *Id.;* VT (G. Smith) 17:46-40-17:48:02.
[48] VT (G. Smith) 17:49:51-17:41:46.
[49] VT (G. Watkins) 19:16:40 - 19:17:20.

contracts are still reasonable and whether all the special contract customers are legitimate threats to bypass Atmos.[50]

3) Atmos' own actions suggest that a Margin Loss Rider would be misused

The AG recommends that the Commission deny Atmos' proposed Margin Loss Rider ("MLR"). The main purpose of the MLR is to allow the Company to recover 50% of any future lost margins between rate cases from captive ratepayers that is lost as a result of the currently executed special contracts or any special contracts Atmos may execute in the future.[51] As Mr. Watkins states in his direct testimony, this would allow Atmos to recover lost margins caused by special contracts that have never been vetted by this Commission.[52] In addition, Atmos would be able to recover lost margin for special contracts it executes in the future without Commission approval. Atmos argues that the Commission has approved this Rider for the Company in a previous case.[53] However, that case was a black box settlement where the Commission was unable to analyze all aspects of the settlement.[54]

As testimony demonstrated repeatedly during the Hearing, this is the first fully litigated rate case Atmos has had before this Commission in well over a decade. A

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[50] *See Application Of Columbia Gas Of Kentucky, Inc. For An Adjustment Of Rates For Gas Service*, Case No. 2013-00167, Order Entered 13 December 2013, Page 8, Paragraph 7. ("As part of its next application for an adjustment of its base rates for gas service, Columbia shall submit the results of its analyses on the threat of by-pass by its special contract customers.")
[51] Rebuttal Testimony of Martin, page 8, lines 5-9.
[52] Direct Testimony of Watkins, page 48, line13 to page 49, line 2.
[53] Rebuttal Testimony of Martin, page 8, lines 14-18.
[54] Case No. 99-070.

black box settlement from 15 (fifteen) years ago is neither binding nor persuasive authority requiring the Commission to allow the MLR in this matter. The AG, and by its own failures the Company itself, have demonstrated that Atmos is incapable of responsible administration of special contracts. The Company should not be awarded an MLR Rider to encourage future execution of additional special contracts. However, if an MLR Rider is permitted, the Commission should exercise maximum conditions and ongoing supervision over such a revenue generating mechanism for Atmos.

4) Atmos has not provided sufficient evidence that any inflation factor is appropriate for certain key expense categories

Atmos' 2.7% generic inflation factor adjustment from applicable operating and maintenance ("O&M") expenses should be disallowed.[55] This adjustment would reduce related expenses by $248,454.[56] As Brief Appendix A demonstrates, information provided in Mr. Densman's Rebuttal Testimony[57] has allowed the AG to accurately calculate the amount of this adjustment to $248,454.[58] Atmos' decision to add an inflationary factor of 2.7% to O&M expenses is unreasonable.

Atmos did not show that there was a proper correlation between the forecasted 2.7% increase in expenses and actual historical changes in these same expenses. The information Atmos provided to demonstrate the reasonableness of the adding an

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[55] *See* Direct Testimony of Densman, page 15, lines 19-21.
[56] Rebuttal Testimony of Densman, page 2, lines 17-21.
[57] *Id.*
[58] *See* Appendix A, AG Table 1, line 4.

inflation factor to expenses actually supports the contrary conclusion. [59] Although Atmos proposes to increase all expenses except labor, benefits, and rent[60] by its 2.7% generic inflation factor, of the eleven (11) expense categories identified by the company, at least **seven (7) categories actually experienced decreases** for the most recent periods available from 2011 to 2012.[61] Atmos has not provided sufficient evidence that any inflation factor is appropriate for these expense categories. As such, the Commission should deny the 2.7% generic inflation factor to O&M expenses.

5) Commission precedent disallows incentive compensation where the measuring factor solely benefits shareholders

As his final recommendation and consistent with clear Commission precedent, the AG recommends that the Commission disallow any incentive compensation from rate base.

In his Direct Testimony, Mr. Ostrander recommended a downward adjustment to Atmos' long-term incentive expense 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.)."[62] The parties are in agreement, within two dollars[63], that the amount of incentive

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[59] Atmos Response to AG 1-112, Attachment 1.
[60] Direct Testimony of Densman, page 15, lines 19-23.
[61] Ostrander at Supplemental and Corrected Testimony of Ostrander, Table BCO-1, page 19, lines 1-4.)
[62] Supplemental and Corrected Testimony of Ostrander, page 44, lines 8-12. (Ellipses in original).
[63] Atmos believes the correct amount is $1,164,454. AG asserts the correct amount is $1,164,456. The difference is almost certainly due to a rounding difference somewhere in the calculations.

compensation proposed to be incorporated into rate base is $1,164,456.[64] Based on information supplied during the Hearing, the AG asserts that the correct adjustment to incentive compensation is to remove the entirety of the compensation package from rate base.[65]

Atmos has based its incentive compensation program purely on benefits to shareholders. Any benefits enjoyed by ratepayers are ancillary to the goal of increasing the stock price of Atmos. This is first made clear by the name of the incentive compensation performance measure of "Earnings per Share", also known as EPS.[66] As Atmos witness Densman explained, "EPS is driven purely by net income divided by outstanding shares."[67] EPS are the goals that Atmos' Board of Directors has defined and that, when achieved, result in a monetary payout to Atmos employees.[68] These payouts are completely unrelated to achieving any goals that would directly benefit rate payers.[69]

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[64] *See* Rebuttal Testimony of Densman, page 13, lines 3-5. Because the AG believes the entire amount of incentive compensation should be removed, as opposed to the 50% discussed by Mr. Densman, the AG has simply doubled the figure to reach 100% of the incentive compensation.

[65] Appendix A, Table 1, lines 2 and 3.

[66] Supplemental and Corrected Testimony of Ostrander, page 45, lines 3-20.

[67] VT (J. Densman) 15:15:39-15:56:50.

[68] VT (J. Densman) 15:55:39-15:55:56 ("EPS is the, is the driver, the goal that is used to determine if a payout of incentive comp is, is done."); *See also* VT (J. Densman) 15:55:56-15:56:28 ("provided we hit the EPS targets established by the BOD there is a there is a threshold, target and maximum, if we, depending on where we hit in those ranges a payout is made.").

[69] Supplemental and Corrected Testimony of Ostrander, page 46, line 17 – page 47, line2. ("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 service quality, improved safety, improved customer service, improved billing procedures, and other customer-driven measures.")

As staff demonstrated during the Hearing, allowing Atmos to proceed with its incentive compensation plan would require the Commission to break precedent set over the last fifteen (15) years.[70] Staff drew the Commission's attention to a 1991 Order that stated the following:

> "Based on a thorough review of the [Key Employee Annual Incentive Plan] provisions, the Commission will exclude these expenses for the following reasons. First, while the plan does include so-called protection clauses for both customers and shareholders, the plan narrative clearly states that, "The Board, the Compensation Committee, and management all agree that the interests of shareholders must be paramount and protected when considering the appropriateness of any compensation program for key employees." The Commission believes that, for a utility, the interests of the shareholders and the customers should be balanced and protected."[71] (citations omitted, bracket in original, emphasis in original)

This case is directly on point. There, the company freely admitted that the purpose of the incentive compensation plan is to benefit shareholders. Here, the company has also admitted that the incentive compensation plan is purely to benefit shareholders.[72]

In a recent case involving Kentucky American Water Co. ("KAW"), the Commission has stated that "the mere existence of such [incentive compensation] plans is insufficient to demonstrate that they benefit ratepayers and that their costs should be recovered through rates" and that the utility must demonstrate why shareholders

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[70] *See* VT (J. Densman) 16:20:54-16:28:34.
[71] *In the Matter of: Application of the Union Light, Heat and Power Company to Adjust Electric* Rates, Case No. 91-370, Order, 5 May 1992, Page 31; Staff Exhibit 2, page 31; VT (J. Densman) 16:24:37-16:25:29.
[72] VT (J. Densman) 15:15:39-15:56:50.

should not bear the costs associated with such plans."[73] There, the applicant went to such great lengths to prove the value of the incentive compensation plan as to produce a study purportedly proving the compensation plan's benefits to customers.[74] The incentive compensation plan was soundly rejected by the Commission.[75] The Commission, through its previous rulings, has established a high bar for evidencing the worth of an employee incentive compensation plan such that the expense of that plan should be incorporated into rate base. Atmos has fallen well short of providing the necessary evidence. As such, the AG urges the Commission to follow its own precedent and reject Atmos' proposal to incorporating the incentive compensation plan into rate base.

6) Atmos' rate case expense filings contain unreasonable charges and should be scrutinized carefully

Atmos has claimed a great sum in rate case expense, much more than the $105,667 Atmos forecasted in its application.[76] Due to numerous questionable expenses, the AG is of the opinion that the rate case expenses claimed should be scrutinized and disallowed unless they are clearly reasonable in amount and unequivocally related to this case.[77]

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[73] Staff Exhibit 3; *In the Matter of Kentucky-American Water Company for an Adjustment of Rates Supported by a Fully Forecasted Test* Year, Case No. 2010-00036, Order, 14 December 2010, page 31 *citing* Case No. 2003-00103, Order of Feb. 28, 2005 at 49.
[74] Staff Exhibit 3, pages 31-32.
[75] *Id.* at 33.
[76] Direct Testimony of Densman, page 18, lines 18-21.
[77] Interestingly, on 25 February 2014 Atmos moved for admission to practice pro hac vice for Douglas Walther, an attorney who represented Atmos throughout the instant matter.

To begin, any and all expenses related to attorney Mark Hutchinson should be disallowed. The AG could find no invoices from attorney Mark Hutchinson in Atmos filings.[78] Because there are no invoices attached to Atmos' filings, it is unclear that Mr. Hutchinson's services were clearly related to Atmos' case. This is especially true in light of the fact that Mr. Hutchinson was Atmos' second local Kentucky counsel used in this case. Mr. Hutchinson and Mr. Hughes are both admitted to the Commonwealth of Kentucky Bar and both signed virtually every filing Atmos made.[79] No explanation has ever been provided as to why Atmos feels the need to secure two local attorneys. The company submitted only a flat fee agreement as proof of Mr. Hutchison's services, as opposed to the detailed invoices filed in support of the services of Mr. Hughes , which have been updated regularly as the case has proceeded.[80] As such, there is no evidence demonstrating that the services of Mr. Hutchison as additional counsel were necessary.

The AG has discovered several other dubious invoicing practices. Mr. Raab has invoiced for 8 hours of Hearing time on the 22nd and 23rd of January, even though the Hearing began and concluded on 23 January 2014.[81] After the Hearing concluded, Mr.

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[78] Atmos' supplemental (24 September 2013) response to AG 1-144(h) states "Mark R. Hutchison works on a flat retainer of $5,000 per month." However, no invoices were located in Atmos' filings from Mark Hutchinson.

[79] For efficiency, the AG will forego citing to every filing Atmos has made in this case, but as an example, see Atmos most recent filing; Atmos Energy Corporations Supplemental Responses to Staffs First Request for Information (14 February 2013).

[80] *See* Atmos Supplemental (14 February 2014) Response to Attorney General's First Data Request, Items 1-140 and 1-143, Attachment 2.

[81] Atmos Supplemental (14 February 2014) Response to Attorney General's First Data Request, Items 1-140 and 1-143, Attachment 1, Page 3 of 7.

Raab billed an additional 4 hours for "rebuttal" on 24 January 2014.[82] Mr. Vander Weide has done essentially the same thing, billing $3,400 for eight (8) hours of Hearing on 24 January 2014.[83] Again, the entire Hearing was held on the 23rd.[84] Accordingly, the Commission should disallow costs for services that could not have possibly been provided. The AG recommends an adjustment to this expense to bring it within reason.

7) Prudent rate making policy dictates that Net Operating Loss Carry-Forward should not be incorporated into rate base.

Atmos has proposed to incorporate $20,125,550 in Net Operating Loss Carry-Forward ("NOLC") Accumulated Deferred Income Taxes ("ADIT") into rate base.[85] Mr. Ostrander elucidated the potential ramifications of allowing NOLC to be continually built into Atmos' rate base.[86] Atmos' response to Hearing DR 1-12 demonstrates the increase of NOLC since 6/30/2010. Every year since Atmos began experiencing NOLC, Atmos' NOLC has increased. In the three years and three months since Atmos first claimed a NOLC, Kentucky's allotment of Atmos' NOLC has ballooned from $9,767,882 to $22,488,082 as of 30 September 2013. This trend of continuously increasing NOLC was the worst case scenario Mr. Ostrander explained during his testimony.[87] These NOLC balances have an expiration date. If Atmos is unable to use the entirely of its NOLC before the expiration date, then millions of dollars will have been built into rate

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[82] *Id.*
[83] *Id.*, page 2 of 4.
[84] *See* Chairman Armstrong's remarks that we managed to give everyone an opportunity to be heard yet still complete the Hearing in one (1) day at VT 19:50:20-19:50:30.
[85] Atmos Energy Corporations Additional Response to Data Requests from Commissions Hearing, Attachment 1, Filed 7 February, 2014. (See note at bottom of page.)
[86] Direct Testimony of Ostrander, 19:01:00.
[87] VT (B. Ostrander) 19:00:35-19:04:35.

base without rate payers seeing any benefit.[88] The Commission could credit the rate payers for the unused portions of NOLC built into rate base that expire, but the Commission will almost certainly face challenges from the Company under the doctrine banning retroactive ratemaking.[89]

Atmos' Vice President of Taxes states that "there is no doubt normalization is required of NOLC ADIT assets"[90] and that "it is unambiguous and clear that the IRC and Treasury Regulations require the normalization of NOLC ADIT assets."[91] The witness's statements are the product of contortion, as demonstrated by rulings in other jurisdictions,[92] the AGs position in this case,[93] Treasury Regulations[94], and the witness's own statements at the Hearing.[95] Atmos would like to lead the Commission to believe that disallowing NOLC to be brought into rate base would violate a Treasury

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[88] *Id.*

[89] *Kentucky Industrial Utility Customers, Inc. v. Big Rivers Electric Corporation.*, 176 P.U.R.4th 371, 1997 WL 197300 Ky.P.S.C.). (The rule against retroactive rate-making is a 'generally accepted principle of public utility law which recognizes the prospective nature of utility rate making and prohibits regulatory commissions from rolling back rates which have already been approved and become final.' *MGTC, Inc. v. Pub. Serv. Comm'n*, 735 P.2d 103, 107 (Wyoming 1987). It further prohibits regulatory commissions, when setting utility rates, from adjusting for past losses or gains to either the utility, consumers, or particular classes of consumers.)

[90] Rebuttal Testimony of McDonald, page 6, lines 18-19.

[91] Rebuttal Testimony of McDonald, page 6, lines 21-22.

[92] AG Exhibit 16, West Virginia Public Service Commission Decision denying petition to reconsider in Case No. 11-1627-G-42T.

[93] *See generally* Testimony, Supplemental Testimony and VT of Bion Ostrander. *See also* VT (P. McDonald) 17:13:05-17:13:32 ("Q: Mr. McDonald, you state in your testimony on page 6 lines 21-22 that 'it is unambiguous and clear that the IRC and Treasury Regulations require normalization of NOLC ADIT assets' correct? A: That is Correct. Q: Mr. Ostrander disagrees with that assertion doesn't he? A: That is true").

[94] Treasury Regulations, Subchapter A, Section 1.167(l)-1(h)(1)(b)(iii) and 1.167(l)-1(h)(2)(i).

[95] VT (P.McDonald) 17:14:25-17:15:00.

Regulation or the U.S. Tax Code.[96] This is simply not true, as acknowledged by Atmos' V.P. of Taxes when he explained that "Normalization violation is not a term that means you have broken the law. It means that there are things you must do differently on prior filings and future filings."[97]

There is precedent for a public utility commission to prevent a utility from building NOLC into rate base.[98] In *Mountaineer Gas Company,* Case No. 11-1627-G-42T, the Public Service Commission of West Virginia ruled on a Limited Petition for Rehearing that: "The Commission calculation of deferred federal income tax expense for rate recovery based on the gross tax over book depreciation deductions for rate recovery is consistent with IRS normalization requirements and supports the Commission decision to include the full $15.7 million of ADITs in rate base [as opposed to allowing the Company to carry forward the lose) as determined from the gross tax over book depreciation deductions."[99] The West Virginia Commission further found that "A normalization violation, if the IRS determined the Commission's decision related to the Minimum Adjustment to ADIT created such a violation, would have an adverse impact on both the Company and its customers"[100] but went on to find that "The Commission is not persuaded by the Mountaineer arguments that its treatment of

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[96] VT (P. McDonald) 17:20:15-17:21:15 (" If the NOL were not allowed to be included in rate base we would be in violation of what's called the normalization provisions which are embedded in the internal revenue code.")
[97] VT (P. McDonald) 17:29:48-10:30:04.
[98] AG Exhibit 16, West Virginia Public Service Commission Decision denying petition to reconsider in Case No. 11-1627-G-42T.
[99] AG Exhibit 16, page 8, paragraph 3.
[100] *Id.*, page 7, paragraph 1.

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."[101] The Commission essentially found that including NOLC in rate base was unreasonable, as was the idea that to prevent the company from incorporating NOLC into rate base would create a tax normalization violation.

The bottom line when determining how to treat NOLC for the purposes of rate base is if NOLC is included in rate base, then Atmos continues to do business as normal and rate payers risk paying hundreds of millions of dollars over the next twenty years for which they will see absolutely no benefit.[102] The implications for disallowing Atmos from rolling NOLC into rate base is Atmos must amend old tax forms, file their taxes differently going forward, and rate payers are protected from providing Atmos an enormous windfall the Company did not earn. [103] For these reasons and those stated previously, the AG recommends rejecting the Company's proposal to incorporate $20,125,550 into rate base.[104]

8) Atmos' Cost of Service Study overwhelmingly disadvantages the residential customer class and, therefore, is not fair, just and reasonable.

Atmos agrees with virtually everything the AG contends regarding the COSS proposed by Atmos. Atmos agrees that residential customers make up roughly 89% of

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[101] *Id.*, page 8, paragraph 2.
[102] VT (B. Ostrander) 19:00:35-19:04:35.
[103] VT (P. McDonald) 17:25:55-17:26:48; VT (B. Ostrander) 18:59:15-19:00:05.
[104] Appendix A, Table 1, line 5.

Atmos total number of customers.[105] Atmos agrees that a cost allocation heavily weighted towards number of customer - which Atmos' COSS does - puts the majority of the company's costs on residential customers.[106] Atmos agrees that, under its COSS, the majority of its revenue requirement has been assigned to residential customers.[107] Atmos even agrees that for the vast majority of Atmos' revenue requirement, its study places the same burden on a veteran's widow living alone on a fixed income, in a small residential apartment, using gas only for cooking, as is placed on a large industrial customer using millions of Mcf a year.[108]

Where the parties disagree is whether this obvious and disproportionate imbalance against residential customers, who are the least able to absorb such a financial burden, is fair, just and reasonable. The AG asserts that such an obvious and disproportionate burden by the COSS cannot result in rates that are fair, just and reasonable under KRS 278.190.

Mr. Watkins has proposed an alternative COSS, which presents a fair, just and reasonable method for allocating the revenue requirement of Atmos.[109] Mr. Raab has summed up the differences between the two studies nicely, stating:

> "The primary difference between Mr. Watkins' study and the Company study is that Mr. Watkins places more reliance on peak demands and volumes to classify and allocate costs than the Company study, which

[105] VT (P. Raab) 14:17:43-14:17:57.
[106] VT (P. Raab) 14:23:52-14:24:01.
[107] VT (P. Raab) 14:21:07-14:21:18.
[108] VT (P. Raab) 14:22:37-14:23:26.
[109] Direct Testimony of Watkins, GAW-4, pages 1-2.

> places more reliance on the number of customers to classify and allocate costs. Specifically, excluding the cost of gas which is not recovered through base rates, the Company's approach indicates that 87% of the total cost of service is related to the number of customers on the system, 11% is related to the demands those customers place on the system and only 2% is related to the amount of natural gas that those customers consumer. In contrast, Mr. Watkins study classifies costs, excluding gas costs, as 49% customer-related, 28% demand-related and 23% commodity related."[110]

Mr. Watkins goal was to create a COSS that is representative of the Company's costs and balanced in the way those costs are allocated. The AG believes an unfair burden is placed on residential customers in the Company's COSS and that Mr. Watkins presents a fair just and reasonable COSS.[111]

To summarize, Atmos' class cost of service study (CCOSS) and class revenue allocation irrationally apportions any increase based on an approach that relies almost entirely on its CCOSS which in turn is a result of assigning costs based on the number of customers (87%), **regardless of their utilization of Atmos' system.** On the other hand, the Attorney General conducted two CCOSSs, one of which is based on roughly 50% of the number of customers and 50% on peak demand and a second study that is based on 50% on the number of customers, 25% on peak demand and 25% on annual usage. The Attorney General's recommendation spreads the increase more equitably amongst the ratepayers and more reasonably assigns revenue responsibility. Simply

[110] Rebuttal Testimony of Raab, page 5, lines 4-14.
[111] See Watkins Schedule GAW-4 for detailed impacts on each customer class based on the Company's COSS and Mr. Watkins.

stated, the Attorney General does not rely merely on a head count of customers as Atmos otherwise requests.

Last, with regard to the current residential fixed monthly customer charge of $14.28, this rate is sufficient for Atmos and should not be adjusted any further because 70% of the total residential base rate revenue is already recovered through the fixed monthly charge; i.e., 70% of residential base rate revenue is collected on a fixed charge basis irrespective of usage and provides more than ample revenue stability to the company[112]. Accordingly, any increase that might be awarded to Atmos should be placed on the delivery charge in order to afford customers the opportunity to lower their bills by way of conservation.

9) Atmos' proposed Return on Equity is unreasonable and the national average better serves as guidance for Atmos' ROE

The testimony of Mr. Vander Weide in Atmos' application originally recommended an Return on Equity ("ROE") of 10.7 percent.[113] However, during Mr. Vander Weide's testimony at the Hearing he lowered his recommended ROE for Atmos to 10.6.[114] Considering that every Atmos rate case since 1999 has been settled, it seems very likely that the 10.7 ROE originally used in the Atmos application was merely intended as a starting point for negotiations with the AG.[115]

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[112] In addition to the fixed monthly charge, Atmos has other mechanisms that further guarantee revenue recovery to stabilize revenue.
[113] Direct Testimony of Vander Weide, page 48, line 12.
[114] VT (J. Vander Weide) 10:14:36-10:15:08.
[115] *See generally* dockets of Atmos General Rate Cases from 1999 to Case No. 2013-00148.

As revealed during the Hearing in this matter, Atmos very recently settled a case in Colorado and used an ROE of 9.72%.[116] In that case, Atmos filed an application requesting an ROE of 10.5%.[117] That case was settled on 20 December 2013.[118] Based on the Regulatory Research Associates, Regulatory Focus, the average ROE for the fourth quarter of 2013 was 9.83% for gas utilities.[119] Atmos settled a case for an ROE eleven (11) basis points lower than the national average. If we look at the previous year's average ROE of 9.94%, then Atmos actually settled the Colorado case for an ROE a full twenty-two (22) basis points lower than average.[120] However, the overall average ROE from 2013 was 9.68%.[121] Having presented this information to Atmos' witness, Commission Staff asked the obvious follow-up question, for which there is really no answer necessary as the question says it all: In light of the settlement and the average 2013 ROE "do you believe that investors expect the Kentucky Public Service Commission to find that a 10.6 or 10.7 ROE is reasonable?"[122]

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[116] VT (J. Vander Weide) 10:19:10-10:20:02.
[117] Advice Letter No. 497 from Karen P. Wilkes, Vice President Regulatory & Public Affairs, Atmos Energy, Colorado/Kansas to the Public Utilities Commission of the State of Colorado. *See* Appendix B.
[118] Stipulation and Settlement Agreement Between Atmos Energy Corporation, Trial Staff of the Colorado Public Utilities Commission, and Energy outreach of Colorado. *See* Appendix C..
[119] Staff Exhibit 1.
[120] PSC Hearing Exhibit 1; VT (J. Vander Weide) 10:18:48-10:18:57.
[121] Staff Exhibit 1.
[122] VT (J. Vander Weide) 10:20:21-10:20:34.

Based on the national average, the Attorney General recommends no greater than a 9.68% ROE[123], which translates into the following cost of capital structure based on Atmos proposed debt to equity ratio[124], introduced at the hearing:

48.2% (debt) x 6.19% (interest rate on debt)	= 2.984
51.8% (equity) x 9.68% (ROE)	= 5.014
	7.99

The above ROE and associated cost of capital accurately reflects the current market conditions, which should be adopted by the Commission. If Atmos can determine that its business is stable and low-risk enough to accept an ROE though settlement of lower than the national average, based on current information, it is the AGs position that Atmos should receive an ROE of last year's national average[125] - 9.68% - or lower.[126] A 9.68% ROE will provide more than a sufficient return to attract investment in the company, represents a fair return and results in just and reasonable rates for Kentucky customers.

10) CONCLUSION

The evidence demonstrates that Atmos Energy Corporation's Application overstates its annual revenue requirement by $9,591,256. The Attorney General recommends that Atmos be rewarded no more than $3,700,009 based on a return on equity of 9.68%. In addition to denying Atmos' revenue request, the Commission

[123] *See* Appendix A, Table 1, line 1.
[124] Direct Testimony of Waller, page 12, lines 5-16.
[125] *See* Staff Exhibit 1.
[126] Appendix A, Table 1, line 1.

should reject Atmos' proposed rate structure that significantly benefits industrial customers at the expense of residential customers and adopt that which the Attorney General recommends, which provides a more balanced approach that aligns the interest amongst Atmos' ratepayers. Any increase that is awarded to Atmos should be placed on the delivery charge, thereby enabling the customers who conserve to lower their bills, versus placing any increase on the monthly charge that is fixed regardless of usage. The current monthly residential customer charge of $14.28 is more than sufficient to provide Atmos with ample revenue stability, especially in light of the other ratemaking mechanisms that Atmos presently employs that guarantees Atmos' revenue[127].

Respectfully submitted,
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[127] See, for example, the fuel adjustment clause (FAC), the company's pipeline replacement program (PRP), the demand side management program (DSM), and the weather normal adjustment (WNA).

Certificate of Service and Filing

Counsel certifies that the Attorney General's Post Hearing Brief is a true and accurate copy of the documents to be filed in paper medium; that the electronic filing was transmitted to the Commission on February 25, 2014; that an original and two copies of the filing will be delivered to the Commission within two business days; and that no party has been excused from preparation by electronic service.

Gregory T. Dutton

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