

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF ATMOS CORPORATION FOR) CASE NO.
FOR A GENERAL RATE ADJUSTMENT) 2015-00343

ATTORNEY GENERAL'S RESPONSES TO DISCOVERY REQUESTS

Comes now the intervenor, the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention, and files the following responses to data requests in the above-styled matter.

Respectfully submitted,
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WITNESS/RESPONDENT RESPONSIBLE

Lane Kollen

REQUEST No.1

Page 1 of 1

The Direct Testimony and Exhibits of Lane Kollen ("Kollen Testimony"), page 4, contain a table summarizing the AG's revenue requirement recommendations. In a format similar to that of Schedule B.1 F in Atmos Energy Corporation's Kentucky Division ("Atmos-Ky") rate application, provide the net investment rate base which supports the AG's "Rate Base Recommendations" portion of this table. The response should use the "Forecasted Test Period 13 Month Average" column on Schedule B.1F as the starting point and identify all the adjustments made to arrive at an AG-adjusted 13-month average test period.¹

RESPONSE:

Please refer to Mr. Kollen's electronic workpapers, which have a rate base schedule that reconciles the rate base reflected in the Atmos filing, as revised by the Company in response to Staff 2-21 to reflect the effects of bonus depreciation, with the AG's adjustments. Also see the attached spreadsheet in the format requested.

ATTACHMENT:

ATTACHMENT 1 - AG Recomm Comp Alloc Factors - Staff_2-21_Att1_-_Fall_2015_KY_Rev_Req_Model_-_Final_Copy_-_External_Links_to_1-59_WPs

ATTACHMENT 2 – AG_1-04_Att5_-_Total_Operating_Expenses-As Summed and Calculated by AG.xlsx

ATTACHMENT 3 – As Filed - Staff_2-21_Att1_-_Fall_2015_KY_Rev_Req_Model_-_Final_Copy_-_External_Links_to_1-59_WPs.xlsx

ATTACHMENT 4 – Atmos Rev Req - AG Recommendation.xlsx

ATTACHMENT 5 – Copy of Staff_1-59_Att26 - KY Plant Data-Fall 2015 case - After Change in Cap Addition Rate.xlsx

ATTACHMENT 6 – New Calc Page out of Model.xlsx

¹ In addition to Commission Staffs need for a complete rate base, the Commission's final Order in this case will need to state the amount of the rate base recommended by the AG.

WITNESS/RESPONDENT RESPONSIBLE

Lane Kollen

REQUEST No.2

Page 1 of 2

Refer to the Kollen Testimony, pages 15-28, wherein the tax treatment of Atmos-Ky's Net Operating Loss Carryforward and Private Letter Ruling ("PLR") request to the Internal Revenue Service ("IRS") are discussed. In Atmos-Ky's prior rate case², the AG recommended that Atmos-Ky seek a PLR and later offered comments on the draft PLR to the Commission and Atmos-Ky.

- a. Explain whether, after the PLR request was filed with the IRS, the AG submitted comments to the IRS. If the AG submitted no comments, explain why.
- b. Identify the utility that received the IRS ruling in PLR 2014-18024 and the regulatory agency that required the utility to seek a PLR.

RESPONSE:

- a. No. After the Request for Letter Ruling is submitted, there is no opportunity for comment by non-taxpayer parties unless there is a conference with the IRS and the non-taxpayer party is invited to the conference. Please refer to Rev. Proc. 2016-1 at the following link, which details the procedures for a taxpayer to request guidance from the IRS, including a Letter Ruling.

https://www.irs.gov/irb/2016-01_IRB/index.html

Although the AG offered comments on the draft Request for Letter Ruling to the Commission and Atmos and sought modifications, it should be noted that counsel for Atmos summarily dismissed the AG's comments on the basis that the AG had no right to co-author the Request. Thus, the AG had no role in drafting the Request for Letter Ruling. Please refer to the attached correspondence from the AG seeking modifications and from counsel for Atmos rejecting any input from the AG. Atmos did not permit any involvement by the AG in the IRS review process.

It also should be noted that the Commission Staff had no role in drafting the Request for PLR or in the IRS review process. The IRS procedures require only that the state regulator be provided a copy of the Request for Letter Ruling and that it confirm that the Request is "adequate and complete." It does not

² Case No. 2013-001 48, *Application of Atmos Energy Corporation for an Adjustment of Rates and Tariff Modifications* (Ky. PSC Apr. 22, 2014).

REQUEST No.2
Page 2 of 2

require the regulator to confirm that it is accurate or allow the Commission to demand changes to the Request even if it is not accurate. The Commission did not address the accuracy of the Request. Please refer to the attached correspondence from the Commission. Finally, it should be noted that the responsibility for the Request for Letter Ruling and its accuracy rests solely with Atmos and its advisors.

- b. Mr. Kollen does not know the identity of the utility. The taxpayer's identity generally is considered confidential.

ATTACHMENTS:

ATTACHMENT 1 – AG's_Exhibit_A.pdf

ATTACHMENT 2 – AG's_Exhibit_B.pdf

WITNESS/RESPONDENT RESPONSIBLE

Lane Kollen

REQUEST No.3

Page 1 of 2

Refer to the Kollen Testimony, pages 28-31 , wherein Mr. Kollen states that the "one-eighth of O&M expense methodology is outdated and inaccurate" and that, due to the lack of a lead/lag study to support Atmos-Ky's cash working capital needs, the Commission should set Atmos-Ky's "[c]ash working capital at \$0 .. though there is no doubt that it should be negative."

- a. Identify any prior cases wherein Mr. Kollen filed testimony with the Kentucky Commission in which he opposed, or took exception to, use of the one-eighth of operation and maintenance expense approach to derive cash working capital.
- b. With Mr. Kollen's having "no doubt" that Atmos-Ky's cash working capital "[s]hould be negative," explain why Mr. Kollen did not present a lead/lag study in order to include a cash working capital amount less than \$0 in Atmos-Ky's rate base.

RESPONSE:

- a. Mr. Kollen addressed the one-eighth formula in Case No. 2000-386, a Louisville Gas and Electric Company environmental surcharge case, and in Case No. 2000-439, a Kentucky Utilities Company environmental surcharge case. In those proceedings, the Commission used the one-eighth formula because it determined that KIUC did not provide a "lead/lag study or other analysis demonstrating that KU does not have a cash working capital requirement." In this Atmos proceeding, Mr. Kollen cited lead/lag studies prepared by Atmos itself and that Atmos provided in response to AG discovery demonstrating conclusively that Atmos does not have a cash working capital requirement.
- b. Mr. Kollen did not believe that it was necessary to do so. Atmos itself prepared multiple lead/lag studies and submitted them in other jurisdictions. Atmos provided these studies in response to AG discovery in this proceeding. Once errors in some of those studies were corrected, every one of the studies prepared by Atmos indicates negative cash working capital. This was true over multiple test years and in all jurisdictions where Atmos submitted these working capital studies. In Mr. Kollen's experience, it is necessary for the utility to perform the lead/lag study due to the necessity to sample the lead and lag days on O&M and other cash expenses. In addition, in Mr. Kollen's experience, where the utility refuses to provide a lead/lag study and the regulator does not use the one eighth formula, the regulator will use \$0 in lieu of a negative amount. Mr. Kollen also would note that it was Atmos' decision not to provide a lead/lag study in this

REQUEST No.3
Page 2 of 2

proceeding. That decision should not be rewarded, particularly when given that Atmos does provide such studies in other jurisdictions. There is sufficient evidence, based on the lead/lag studies that are available in response to discovery in this proceeding and that are part of the record in this proceeding, that Atmos has negative cash working capital. An allowance of \$0 is reasonable given that evidence.

WITNESS/RESPONDENT RESPONSIBLE

Richard A. Baudino

REQUEST No.4

Page 1 of 2

Refer to the Direct Testimony of Richard A. Baudino ("Baudino Testimony"), pages 13-14. Describe the specific risks of Atmos Energy with regard to the three major categories of business risk identified, and indicate how Atmos-Ky contributes specifically to, or tends to alleviate, those risks.

RESPONSE:

Mr. Baudino's testimony referred generally to major types of risks that face investors. He also noted on page 14 that bond and credit rating agency reports "are tools that investors use to assess the risk comparability of firms." In his evaluation of Atmos' overall risk, Mr. Baudino reviewed the Company's 10-K report as well as bond and credit rating agency reports provided by Atmos in response to AG DR No. 1-33. In response to this data request, Mr. Baudino will cite to specific sections of certain reports that discuss Atmos' business and financial risk. Please refer to the reports provided in response to AG DR No. 1-33 for more details of the rating agencies' discussion of risk.

Regarding the ratings drivers for Atmos, for example, Moody's December 17, 2015 reported noted the following:

- Diverse array of generally supportive regulatory jurisdictions.
- Low business risk natural gas operations.
- Consistent financial performance with stable credit metrics.

Moody's went on to note that Atmos' A2 rating "is supported by the low risk of its LDC operations in mostly constructive regulatory jurisdictions, good operating history, consistent credit metrics, and a conservative management approach." In Mr. Baudino's opinion, this discussion supports Atmos' lower risk A2 credit rating.

Fitch's April 13, 2015 report on Atmos noted several relevant factors that, other things being equal, tend to lower the Company's business risk. These factors are:

- Constructive regulatory environment across all jurisdictions.
- Stable earnings and cash flows. Fitch cited annual ratemaking, weather normalization, purchased gas adjustment clauses, and infrastructure recovery mechanisms.

REQUEST No.4
Page 2 of 2

Fitch's July 1, 2015 report reflected that it had upgraded Atmos Energy's long-term issuer default rating to A- from BBB+ and raised its senior unsecured debt rating to A from A-. Fitch's report noted that key ratings drivers were constructive regulatory mechanisms, large geographically diverse operations in high growth markets, and capex growth and timely recovery. In Mr. Baudino's opinion, these favorable factors tend to lower business risk for Atmos overall. It should also be noted that Fitch described Atmos' non-regulated operations as having a higher level of business risk than the Company's regulated operations. Regarding financial risk, Fitch noted the declining levels of debt and its declining cost of debt. Mr. Baudino views this as a decline in the financial risk of the Company going forward. It is important to note that Fitch stated that it expected Atmos' capitalization to be maintained over the next few years at close to 50% debt and 50% equity. This is a lower equity ratio than Mr. Baudino recommends in this case, which would tend to lower the financial risk of the Atmos Ky. jurisdiction relative to Atmos as a whole.

Standard and Poor's also provided a discussion of the business and financial risks for Atmos in its report dated October 29, 2015. S&P noted that Atmos' business risk is "excellent" and its financial risk "significant". With respect to the Company's excellent business risk profile, S&P noted "the company's regulated natural gas utility operations that benefit from generally constructive regulatory frameworks in eight states, a relatively large and diverse customer base, and low operating risk."

Regarding the Kentucky jurisdiction, the operation of the weather normalization adjustment (WNA), the Pipeline Replacement Rider (PRP) and purchased gas adjustment (PGA) clauses all lower business risk. In particular, the WNA smoothes revenue and earnings volatility due to changes in weather. The PGA allows Atmos to pass through changes in gas costs to customers relatively quickly. The PRP provides the Company ongoing collection of costs relating to eligible pipeline replacement investment without having to file for a rate proceeding to collect those costs.

Finally, Atmos Energy is traded on the New York Stock Exchange and can be considered a liquid investment.

WITNESS/RESPONDENT RESPONSIBLE

Richard A. Baudino

REQUEST No.5

Page 1 of 1

Refer to the Baudino Testimony, page 17. Explain why a period shorter than six months is not used in order to calculate a more current dividend yield.

RESPONSE:

Mr. Baudino uses a 6-month period over which to calculate the average dividend yield in order to smooth out possible monthly stock price variations. In Mr. Baudino's view, a 6-month period represents a reasonable basis for calculating the comparison group dividend yield for purposes of estimating the investor required return on equity for regulatory purposes. Shorter periods of time, such as a 3-month period, may be subject to random or anomalous stock price variations that could result in an unrepresentative group dividend yield going forward.

WITNESS/RESPONDENT RESPONSIBLE

Richard A. Baudino

REQUEST No.6

Page 1 of 1

Refer to the Baudino Testimony, page 20, and Exhibits RAB-4 and RAB-6.

- a. Explain why the current dividend yield is multiplied by one plus one-half the expected growth rate ("g") instead of multiplying by one plus g.
- b. Explain why median values are included in evaluating investor expected growth rates.
- c. Explain whether the internal growth rates as shown in column (3) at the tops of Exhibits RAB-4 and RAB-6 are used in calculating the expected dividend yields in those exhibits.

RESPONSE:

- a. One plus one-half the growth rate was used as a reasonable estimate of how the dividend will grow in the coming year. In other words, one-half "g" provides an average growth rate over the next year (D1). Using a full "g" assumes that next year's dividend will have the full amount of dividend growth applied to the current dividend. This may not be correct depending on the timing of how companies make their decision to raise the dividend.
- b. The median is used as another measure of central tendency to estimate investor expected growth. The median is not influenced by very low or very high individual numbers in the way that the average may be. Thus, the median provides additional useful information with respect to growth.
- c. Mr. Baudino did not use the internal growth rates in calculating expected dividend growth.

WITNESS/RESPONDENT RESPONSIBLE

Richard A. Baudino

REQUEST No.7

Page 1 of 1

Provide Exhibits RAB-3 through RAB-8 to the Baudino Testimony in Excel spreadsheet format, with all cells unprotected and with individual formulae or equations accessible in all cells so the calculations can be followed.

RESPONSE:

Please refer to the attached spreadsheet.

ATTACHMENT:

ATTACHMENT 1 – Atmos_2016_ROE.xlsx

WITNESS/RESPONDENT RESPONSIBLE

Richard A. Baudino

REQUEST No.8

Page 1 of 1

Refer to the Baudino Testimony, page 29, lines 5-7. Describe the circumstances under which Mr. Baudino envisions the Commission changing the rate base or modifying the amount of short-term debt. Explain whether he is referring to a situation involving something other than a general rate case.

RESPONSE:

This section of Mr. Baudino's testimony refers to what happens arithmetically if the Commission were to change the amount of short-term debt or the amount of rate base based on the evidence presented in this case. Since the commitment fees are a fixed amount, if the Commission were to increase the amount of short-term debt, for example, it would have to modify the calculation of short-term debt in order to account for the fixed cost of the commitment fees that the Company wishes to include in the capital structure cost of short-term debt. Otherwise, the Company would over-collect the commitment fees. Placing this fixed cost in O&M will ensure that the Company collects the correct amount of the commitment fees, no more and no less.

WITNESS/RESPONDENT RESPONSIBLE

Richard A. Baudino

REQUEST No.9

Page 1 of 1

Refer to the Baudino Testimony, pages 29-33, wherein Mr. Baudino recommends that Atmos-Ky's test-period common equity ratio be reduced from 55.32 percent, which he characterizes as unreasonable, to 52.99 percent.

- a. While he makes no mention of it in his testimony, explain whether Mr. Baudino is aware, as stated in the Direct Testimony of Gregory K. Waller at page 36, that the June 30, 2015 capital structure of Atmos Energy Corporation included common equity of 54.5 percent.
- b. While he makes no mention of it in his testimony, explain whether Mr. Baudino is aware that the 55.32 percent common equity ratio Atmos-Ky proposes would represent the median value among the common equity ratios of the gas utility group shown on page 32 in Table 4 of his testimony.
- c. Confirm that Table 4 shows that Atmos Energy's 2015 common equity ratio is 56.5 percent.

RESPONSE:

- a. Mr. Baudino is aware of Mr. Waller's testimony of page 36, in which he cited the 54.5% equity ratio.
- b. Mr. Baudino did not perform the calculation of the median equity ratio for the gas utility group.
- c. Mr. Baudino confirms the 56.5% number.