COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In The Matter of:

ELECTRONIC APPLICATION OF ATMOS	)	
ENERGY CORPORATION FOR AN ADJUSTMENT	)	CASE No.
OF RATES AND TARIFF MODIFICATIONS	)	2017-00349

POST-HEARING BRIEF
OF THE KENTUCKY ATTORNEY GENERAL

Respectfully submitted,

ANDY BESHEAR
ATTORNEY GENERAL

REBECCA W. GOODMAN
LAWRENCE W. COOK
JUSTIN M. McNEIL
KENT A. CHANDLER
ASSISTANT ATTORNEYS GENERAL
700 CAPITOL AVE., STE. 20
FRANKFORT KY 40601
(502) 696-5453
FAX: (502) 573-8315
Rebecca.Goodman@ky.gov
Larry.Cook@ky.gov
Justin.McNeil@ky.gov
Kent.Chandler@ky.gov

TABLE OF CONTENTS

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In The Matter of:

ELECTRONIC APPLICATION OF ATMOS	)	
ENERGY CORPORATION FOR AN ADJUSTMENT	)	CASE No.
OF RATES AND TARIFF MODIFICATIONS	)	2017-00349

ATTORNEY GENERAL'S POST-HEARING BRIEF

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.

I. STATEMENT OF THE CASE

On August 25, 2017, Atmos Energy Corporation ["Atmos"] filed its notice of intent to file the instant general rate case. Due to a filing deficiency, the application was not deemed filed until October 6, 2017. The Attorney General filed his motion to intervene, which was granted on October 24, 2017.

On October 27, 2017, the Commission entered an order in Case No. 2017-00308 [1] which, *inter alia*, found that Atmos' costs of replacing pipelines under its Pipe Replacement Program ["PRP"] has more than doubled, and that, "[t]his significant increase in cost warrants a more detailed review of Atmos's PRP, which the Commission will conduct in its currently pending rate case."

[1] *In Re* Electronic Application of Atmos Energy Corporation for PRP Rider Rates.

On March 19, 2018 in Case No. 2018-00039, the Commission approved a settlement between Atmos and the Attorney General to allow for an interim reduction in rates in order to reflect the reduced corporate tax rate implemented under the Tax Cuts and Jobs Act ["TCJA"].[2] As a result of the Final Order issued in that case, the following rates were reduced: base rates by approximately 5.6%; the PRP by approximately 9.7%; the residential customer charge from the current $17.50 to $16.52 per month; the gas delivery charge from $1.5340 to $1.4483 / Mcf; and the Performance Based Ratemaking tariff from $3.29 to $2.97.

Following several rounds of discovery in the instant case, the Attorney General sponsored and filed direct testimony of two expert witnesses on January 17, 2018. An evidentiary hearing was held on March 22, 2018, and both Atmos and the Attorney General filed responses to post-hearing data requests on April 6, 2018.

II. ARGUMENT

A. The Commission Should Deny Atmos' Proposed Annual Review Mechanism

The Commission's current ratemaking system is founded upon well-established statutes, administrative regulations, and decades of precedents found in both its own orders as well as court rulings. This stable, predictable system allows the Commission to comprehensively examine a utility's revenues, expenses, investments and cost of capital. The Commission's current regulatory system affords the deliberation necessary to provide for both

[2] As the Commission noted in that case, ". . . accepting the Settlement Agreement will allow the Commission to fully review and determine in the future both 1) the appropriate level of rates to be charged due to the tax rate reduction between January 1, 2018, and the date new rates are approved in Atmos's pending general rate case, and 2) the adjustments, if any, that will need to be made to reflect the differences between the interim rates and the level of rates subsequently determined to be appropriate." Case No. 2018-00039, Final Order dated March 19, 2018, p. 3.

consumer protections and safe, reliable service. Jurisdictional utilities today are free to file base rate petitions on an "*as and when needed*" basis. In fact, since 2013, Atmos has been filing rate cases approximately every two years.

However, Atmos in the instant case proposes a new tariff, the "Annual Review Mechanism" ["ARM"] that would allow it to engage in *annual* formulaic, reimbursement ratemaking.[3] In support of the ARM, Atmos states the mechanism would, *inter alia*, settle concerns regarding whether the Company's earnings are too high, streamline the ratemaking process, and eliminate regulatory lag.[4] In addition, Atmos would have the Commission believe that the ARM would provide a more "rational" method of allowing the Company to track and recover its costs,[5] and would provide benefits to ratepayers because the ARM proceedings would allegedly cost less than normal rate cases.[6]

To date, this Commission has never approved a jurisdictional utility to utilize formula ratemaking with respect to base rates, and neither KRS Chapter 278 nor the administrative regulations promulgated thereunder remotely contemplate or permit such a ratemaking scheme. The Attorney General believes that for the following reasons, the Commission must continue to refrain from allowing formula base ratemaking mechanisms such as the ARM.

1. Regulatory Lag – When it Exists – is Good for Both Utilities and Their Customers

While the concept of regulatory lag could be defined in several different ways, the common theme is that a delay occurs between the time that a utility incurs costs, and the time

---

[3] The proposed ARM mechanism largely mirrors the Company's "Customer Rate Stabilization Mechanism" it proposed in Case No. 2006-00464, which it withdrew in a Commission-approved settlement.
[4] *See, e.g.,* direct testimony of Gregory K. Waller, pp. 5-11; Direct Testimony of Mark A. Martin, pp. 19-20.
[5] Waller direct testimony, p. 6.
[6] Martin direct testimony, pp. 19-20.

it recovers those costs.[7] When a utility files for an increase in base rates, it effectively shifts risk associated with regulatory lag from itself to its ratepayers. The decision of whether and when to file a base rate case, and the particular relief to pursue therein lies solely with a utility. As such, Atmos, just as any other jurisdictional utility already possesses the discretion and ability to initiate traditional general rate case filings on an annual or even more frequent basis if it should so choose. Clearly, Atmos' financial destiny lies in its own hands.

Regulatory lag imposes discipline and responsibilities on utility operations and investments. Far from being a problem to be overcome, regulatory lag ensures both efficient use of resources and affordability of rates. In fact, the absence of regulatory lag would result in costs being passed to ratepayers on a dollar-for-dollar basis. If the utility can achieve such virtually guaranteed cost recovery, why should it engage in prudency and sound decision-making practices? Clearly, lack of any meaningful regulatory lag results in a utility passing up opportunities to reduce ratepayer costs. When cost recovery is not "given" or "certain," but rather in significant measure discretionary as to the scope of the cost incurred, the amount of the cost, and the timing of the cost – such as under Kentucky's existing utility regulatory framework -- utility management is forced to exercise sound management practices designed to reduce costs. Regulatory lag thus provides a key incentive to utility management to mold and craft its behavior to strive for innovation and to achieve productivity gains in order to maintain earnings between rate cases.

The presence of regulatory lag thus incentivizes efficiency and cost reduction, which in turn enhances profitability. Whereas profitability obviously inures to shareholders' benefit,

---

[7] *See, e.g.,* James C. Bonbright, Albert L. Danielson & David R. Kamerschen, *Principles of Public Utility Rates*, p. 383 (2nd Ed. 1988), which defines "regulatory lag" as: "the quite usual delay between the time when reported rates of profit are above or below standard and the time when an offsetting rate decrease or rate increase may be put into effect by commission order or otherwise."

nonetheless ratepayers *should* also benefit when profits derived from such cost savings increase because the need for rate increases should diminish. Atmos' ratepayers and shareholders have clearly benefited from regulatory lag under Kentucky's existing regulatory scheme.

Atmos' ARM proposal, however, would rob ratepayers of the benefits they receive from regulatory lag, and would instead shift all financial risk from the company's management to the ratepayers. Given that Atmos already benefits from weather normalized sales, a PRP that provides immediate recovery of capital costs virtually free of regulatory lag, a performance-based rate mechanism,[8] and a gas cost recovery mechanism that even allows the company to recover its net uncollectible gas cost,[9] the company is obviously not hurting – indeed, it appears to be *thriving*. The ARM would negate the time-honored principle that utilities should be incentivized to operate their companies in a prudent, cost-effective manner, and instead would allow Atmos to operate its system with no consideration of efficiency, only profits. Clearly, Atmos' proposal is a solution in need of a problem.

2. The ARM Would Provide Atmos an Impermissible Guaranteed Rate of Return

The very words of Atmos' proposed ARM tariff clearly indicate that the mechanism would in fact provide for a *guaranteed* rate of return:

> "Annual Reconciliation Revenue Requirement is the revenue requirement necessary to adjust the actual return on equity to the Authorized Return on Equity for the Forward Looking Test Year immediately completed, all determined in accordance with the Approved Methodologies." [10]

---

[8] *See* tariff pages 18-29.

[9] *See, In Re* Gas Cost Adjustment Filing of Atmos Energy Corp., Case No. 2018-00116, Application, pp. 4-5.

[10] Tariff Sheet 42, subpart E. *See also* Tariff Sheet 42.2, § VI ("Based upon the Forward Looking Test Year and the Approved Methodologies, the Company's tariff rates *shall be adjusted* to provide for the Company to earn the Authorized Return on Equity.")[emphasis added]; and Video Transcript of Evidence ["VTE"] beginning at 1:42:40, where Atmos witness Waller acknowledged that under the ARM, if the company is not earning its authorized rate of return, rates would be adjusted upward to insure that it does in fact earn the authorized rate of return.

Moreover, given that both the setting of new ARM rates and a true-up adjustment would both occur in a period of less than one year, it would be nearly impossible for Atmos' actual earned rate of return to ever be lower than its allowed rate of return. The use of an extraordinarily powerful guaranteed rate of return mechanism such as the ARM is clearly unwarranted for regulated gas utilities such as Atmos, which enjoy a lower beta, and thus lower risk than the market as a whole.[11]

Under the Commission's existing rubric for reviewing a utility's cost of capital, credit ratings play a key role in providing the reasons for a company's debt and equity costs. Under the proposed ARM, however, the sole determinative factor in each review are the values set forth in the formula – any changes in credit ratings, and the reasons thereof, will ultimately have no bearing on the Commission's decision. The formula, including the allowed ROE, could be in effect for an extended period unless changed in a base rate proceeding.[12]

In his seminal treatise on utility regulation, Professor James C. Bonbright states:

> "Regulation, it is said, is a *substitute for competition*. Hence its objective should be to compel a regulated enterprise, despite its possession of complete or partial monopoly, to charge rates approximating those which it would charge if free from regulation, but subject to the *market forces* of regulation."[13]

As is the case with most utility commissions whose statutory schemes are based on rate of return regulation, the Kentucky Commission puts Professor Bonbright's statement that regulation is a substitute for competition into action by allowing jurisdictional investor-owned utilities only the *opportunity* to earn a fair rate of return.[14] Utilities should be given a reasonable opportunity to earn a return on and of their investments, but there is no guarantee. Moreover,

---

[11] *See* direct testimony of Richard A. Baudino, p. 39 lines 9-10.
[12] Waller direct testimony, Exhibit GKW-3, pp. 6-7, 19.
[13] Bonbright, *supra*, p. 141 [emphasis added].
[14] *See, e.g., In Re* Electronic Joint Application of PNG Companies LLC, Drake Merger Sub Inc., and Delta Natural Gas Co., Inc. for Approval of an Acquisition of Ownership and Control of Delta Natural Gas Co., Inc.,

as Professor Bonbright points out: ". . . private companies receive no guaranty of their ability to enjoy a fair rate of return."[15] Thus where the mere opportunity to earn a fair return is replaced with a guaranteed certainty that the return will be recovered, it is axiomatic that regulation is no longer a surrogate for competition. Such a development would in fact turn Kentucky's regulatory scheme on its head.

3. The ARM's Scope of Review Would Be a Self-Fulfilling Prophecy

The Commission's current base rate case review affords Commission Staff and intervenors the opportunity to engage in a comprehensive review of the utility's revenues, expenses, investments and cost of capital. However, the ARM would severely curtail the scope of review and discovery, such that even the Commission itself would be precluded from probing into areas not specified in the established formulas.[16] Exhibit GKW-3 attached to Mr. Waller's direct testimony attempts to explain the various filing requirements the ARM would purportedly address, but in essence this document illustrates that Atmos' intent is to self-select which filing requirements it intends to provide in ARM filings.[17] No explanation is provided of the *mandatory* filing requirements set forth in 807 KAR 5:001 § 16 that the ARM would deliberately not address in its attempt to circumnavigate the ratemaking process. For

---

Case No. 2017-00125, Order dated Aug. 3, 2017, p. 3 (". . . the Commission can grant only the opportunity to earn a fair rate of return"; and *In Re* Brandenburg Telephone Co., Inc., Case No. 92-563, Order dated March 25, 1994, p. 7, 1994 WL 148731 (Ky.P.S.C.).

[15] Bonbright, *supra*, p. 96.

[16] *See* Waller direct p. 10, lines 9-13: "By first establishing specific calculation methodologies and then filing only the information necessary to properly calculate the Company's cost of service, the ARM ensures that time is not spent reviewing and investigating unneeded information or re-litigating matters that have been addressed by the Commission in prior proceedings." Moreover, as Dr. Vander Weide stated at the evidentiary hearing, it is good for the Commission to consider the latest arguments, be open to new ideas, and the setting of a rate case is very helpful for those purposes. VTE at 11:33:24 – 11:34:27.

[17] *See, e.g.* Waller direct testimony p. 8: "The company does not propose to submit testimony . . ."; and p. 10:" The proposed ARM does, however, seek to lessen the burden on the Commission, Commission staff and interveners by streamlining the traditional rate making process. By first establishing specific calculation methodologies and then *filing only the information necessary to properly calculate the Company's cost of service,* the ARM ensures that time is not spent reviewing and investigating unneeded information or re-litigating matters that have been addressed by the Commission in prior proceedings." [emphasis added]

example, during the evidentiary hearing witness Waller testified that Atmos does not provide state-specific ROE information between rate cases because it would require too many calculations,[18] but that the Company did provide some of the information required by 807 KAR 5:001 § 16(8)(k)[19] in his rebuttal testimony exhibit GKW-R-1. However, that exhibit in fact does *not* provide the information for the ten most recent calendar years for Atmos' Kentucky jurisdiction as mandated. If Atmos cannot provide the information the Commission *already* requires to reach its decision under the existing regulatory model, why should the Commission believe Atmos would provide it in the ARM? The Commission should ensure that jurisdictional utilities provide the data necessary for the Commission to reach its decisions based on the record.

Moreover, the company itself would be authorized to self-determine the scope and growth of both forecasted and actual capital spending and operating expenses.[20] This ability to *self-determine* ratebase growth, combined with the loss of Commission oversight over these areas would eliminate procedural and behavioral protections inherent in existing rate case procedures which are designed to limit capital and operating expenditures, and to place a priority on capital expenses designed to enhance efficiencies and savings.[21] As Attorney General Witness Lane Kollen points out:

> The parties may or will have reduced discovery opportunities, no procedural opportunity to contest or seek to modify the Company's requests or methodologies from those set forth in Mr. Waller's Exhibit GKW-3, no procedural opportunity to brief issues to the Commission, no procedural opportunity for the adjudication of contested issues or to seek

[18] VTE 2:51:54. It should be noted that other jurisdictional utilities are capable of providing this information. *See, e.g., In Re* Electronic Investigation of the Impact of the Tax Cuts and Jobs Act on the Rates of Columbia Gas of Kentucky, Inc., Case No. 2018-00041, company's response to Staff's Initial Data Requests Item no. 3, provided only two weeks after Staff filed its requests.

[19] "Comparative financial data and earnings measures for the ten (10) most recent calendar years, the base period, and the forecast period."

[20] Direct testimony of Lane Kollen, p. 69.

[21] *Id.*, at 69-70.

> modification of the requests or methodologies, and no procedural opportunity to recommend different capital structures, cost of debt, or return on equity. *In other words, the Company will have nearly free reign to incur and recover costs through continued increases in costs*. . . . The ARM essentially guarantees the utility's authorized return at whatever level of capital expenditure or expense. This is precisely the wrong incentive from a ratemaking policy perspective.[22]

4. The ARM Would Remove Ratepayer's Interests From Consideration

The implementation of the ARM effectively removes ratepayers' interest from the Commission's consideration. The sole consideration of the ARM is a mere equation, and the input of data therein. This type of automatic ratemaking ignores several key, and precedential, court rulings holding that rate-making commissions are required to consider ratepayer interests in setting rates.

In *Federal Power Comm'n v. Hope Nat. Gas Co*.,[23] the U.S. Supreme Court addressed the need to consider consumer interests and affordability in setting rates. The Court noted that in prior rulings, it has found that a rate setting Commission is:

> ". . . not bound to the use of any single formula or combination of formulae in determining rates. Its rate-making function, moreover, involves the making of 'pragmatic adjustments.'.. . . Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling."[24]

Moreover, in the ratemaking process, "the fixing of 'just and reasonable' rates, involves a balancing of the investor *and the consumer interests*."[25] This Commission is required to consider more than just the cost input that Atmos wishes to recover in the formulaic ARM tariff. Rather, the Commission must balance *all* interests – including those of the consumer, which

---

[22] *Id*. at 69-70 [emphasis added].
[23] 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1944).
[24] *Id*., citations omitted. *Id*., 64 S. Ct. 281 at 287 (citing *Federal Power Commission v. Natural Gas Pipeline Co*., 315 U.S. 575, 586, 62 S. Ct. 736, 743, 86 L.Ed. 1037).
[25] *Id*., 64 S. Ct. 281, 288 [emphasis added].

obviously is predicated upon the establishment of just rates that they are able to pay. The ARM would preclude the Commission's discretion in setting just and reasonable rates because the tight constraints of Atmos' formula leave no room for consumer interests. Atmos' proposed ARM turns ratemaking and Supreme Court precedent on its head by focusing solely on the 'method employed' and ignoring the reasonableness of any result.

Furthermore, in *Kentucky Industrial Utility Customers, Inc. v. Kentucky Pub. Serv. Comm'n*, 504 S.W.3d 695 (Ky. App. 2016), the Court of Appeals, in finding the Commission's approval of a renewable energy production agreement ["REPA"] to be unreasonable found that although the REPA may have met the statutory requirements for the REPA itself, nonetheless ". . . [f]airness, justness and reasonableness remain the determinative considerations."[26] In overruling the Commission's approval of the REPA, the Court of Appeals further noted:

> "Because utilities are allowed to charge consumers only 'fair, just, and reasonable rates' under KRS 278.030(1), *the [Commission] must ensure that utility rates are fair, just, and reasonable to discharge its duty under KRS 278.040 to ensure that utilities comply with state law*."[27]

The Attorney General believes that Atmos' proposed formulaic ARM would, by definition, remove consumer interests from its self-defined ratemaking equation, and would impermissibly narrow the Commission's attention to merely the contents and numbers that would populate Atmos' applications. The failure to consider ratepayer interests would be statutorily myopic, and would impermissibly remove the Commission's discretion in determining what constitutes a fair, just and reasonable rate. The Commission should thus deny Atmos' proposed ARM.

---

[26] *Id*. at 707.
[27] *Id.* at 705 (quoting *Kentucky Pub. Serv. Comm'n v. Com. ex rel. Conway*, 324 S.W.3d 373, 377 Ky.2010)) [emphasis added].

5. The ARM Would Reverse the Utility's Burden of Proof, in Contravention of KRS 278.190

Under the ARM's proposed terms, once the formulas are established, Atmos' only burden would be to populate the formulas with data and file them. The burden of proof would then shift to Commission Staff and intervenors to find adjustments, errors, or to establish that the amounts sought in the formula would not lead to fair, just and reasonable rates. This would be a direct violation of KRS 278.190 (3), which requires, in pertinent part:

> "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*. . ."

Even if the legality of the ARM is somehow upheld, the approval of a cost in any particular ARM proceeding would create a precedential presumption of reasonableness in future ARM proceedings. In order to meet such a reversed burden of proof and overcome any such presumptions of reasonableness, intervenors and Commission Staff would need to engage in an even *more* comprehensive review than they otherwise would in a regular base rate case. Intervenors would likely need to retain additional experts and file even more testimony than they would in a normal base rate case. Such additional efforts will only add costs and staffing burdens to intervenors and Commission Staff.[28] Moreover, each annual ARM filing would have to be concluded within only four months,[29] as opposed to the current six-month suspension period provided in KRS 278.190 applicable to a fully-forecasted test period. Additionally, the company would initiate its true-up filing only a few months following the conclusion of the annual filing. Whereas Atmos contends that the ARM would

---

[28] *See* Kollen direct testimony, p. 69.
[29] *See* Tariff Sheet 42.2.

"streamline" the rate case process and reduce rate case expense, it would likely have the opposite effect of bogging-down the Commission and intervening parties, and increasing their administrative and litigation costs.

Atmos' apparent 'solution' to rate case frequency and significant rate case expense is to *ensure* annual rate increases, and to guarantee full recovery of all costs in each ARM proceeding. In this manner, all of the company's financial risks would be shifted to ratepayers, and the elimination of regulatory lag would entrench what is certain to become an irrevocable pattern of inefficient operation and spiraling cost escalation. The ARM is clearly designed to enhance shareholders' market returns at the expense of ratepayers.

Alternatively, if the Commission should approve the ARM, it should: (a) impose the additional safeguards set forth in Mr. Kollen's response to the Commission's data requests to the Attorney General;[30] and (b) require a major reduction in its authorized return on equity due to the significant risk reduction the company would receive.[31]

While the Attorney General disagrees with Atmos' ARM proposal, nonetheless he is concerned that rate case expense for all investor-owned utilities ["IOUs"] has increased dramatically over the last several years. Today, IOUs are incentivized to employ as many resources as they wish in support of their base rate filings. Although utilities under the Commission's current ratemaking rubric bear the burden of proof, nonetheless they should not be given a blank check – at ratepayers' expense – to support their rate increases.

In the instant case, the record establishes that Atmos should have never filed for a rate increase at this time. As discussed in greater detail throughout this brief, the Attorney

---

[30] *See* Mr. Kollen's response to Commission Staff's data requests to the Attorney General, item no. 9.
[31] *See, e.g.,* Ameren Illinois Co. rate filing, Illinois Commerce Commission Case No. 17-0197, p. 9, which awarded that utility a return on equity of 8.4% in its formula rate filing.

General's concerns with the Company's current application include, but are not limited to: (a) an excessive return on equity; (b) failure to include the annualized effect of new debt issued to replace a maturing long term debt issue at less than half the interest rate of the old debt; (c) unreasonable and unrealistic increases in forecast gross plant additions; (d) failure to make appropriate ratemaking adjustments to reduce ratebase for various income tax-related costs (unrelated to the federal income tax rate reduction); (d) failure to use a reasonable calculation of cash working capital; (e) unreasonable and unrealistic increases in forecast O&M expenses compared to actual expenses; (f) failure to remove all incentive and stock-based compensation expense; (g) failure to remove excessive retirement plan expenses; and (h) unreasonable and unrealistic increases in forecast ad valorem tax expense compared to actual expenses. Therefore, the Attorney General urges the Commission to deny any rate case expense to the Company. Doing so will incentivize the Company's management and shareholders to file rate cases only when necessary, which will also support and encourage the principle of regulatory lag to the greatest extent possible.

B. Atmos' Pipeline Replacement Program and Rider Should be Terminated or Alternatively, Capped

In 2009, the Commission authorized Atmos to initiate its PRP tracking mechanism, in which it recovers a return of all capital investments made, and a return on, all capital investments made under that program.[32] At that time, Atmos estimated that it would need to replace 250 miles of bare steel mains and services, at a total approximate cost of $124 million. The company's estimated rate of capital expenditure for the PRP at that time was $6.7 million for the first year, which would increase to $10 million annually by the last year.[33]

[32] Case No. 2009-00354, Final Order dated May 28, 2010.
[33] *See* Case No. 2009-00354, direct testimony of Earnest B. Napier, P.E., pp. 12-13, 19, relevant pages of which have been attached as Exhibit _(LK-17) to the direct testimony of Lane Kollen in the instant case.

Nine years on from the PRP's inception, however, cost projections have escalated in an exponential manner such that by 2025, Atmos now estimates it will have spent nearly *$700 million* [34] on PRP projects – more than 5½ times greater than the original estimate. Absent some sort of Commission action, most of the projected cost increases will occur from the end of FY 2017 going forward, during which time costs are now projected to escalate at a pace four times faster than the original projection set forth in Case No. 2009-00354.[35] Each year, the Company incorporates an escalation rate of 12% in its PRP planning.[36] During 2018, 58% of *all* of Atmos' costs will be collected via the PRP.[37] These new expenditures will ***more than double*** the company's entire ratebase in just an 8-year time span, even assuming, incorrectly, that there is no growth in ratebase from non-PRP capital expenditures.[38] From 2018-2022, the Company projects its annual margins will increase by over 62.5%.[39] The Commission should find this exponential growth of Atmos' ratebase concerning, especially because Atmos is not a utility experiencing growth – in fact, the customer base growth rate is *nearly flat*.[40]

Just as disturbing as the astronomical price escalation is the fact that despite Atmos' assertions that the PRP would bring a significant reduction in leakage and reduced O&M costs,[41] *virtually no such savings* have been achieved to date.[42] Clearly, the Company's PRP

---

[34] Case No. 2017-00349, Company response to PSC 2-18, attached as Exhibit__(LK-18) to the direct testimony of Lane Kollen in the instant case. *See also* Case No. 2017-00308, Atmos' response to AG 1-1.
[35] *See* Kollen direct testimony, p. 72.
[36] *See generally* Martin rebuttal testimony p. 9; and questioning from Vice Chairman Cicero, VTE 10:15:00 – 10:16:40; 10:46:56 – 10:47:25.
[37] Waller direct testimony, p. 7.
[38] *See, e.g.,* Kollen direct testimony, pp. 70-75.
[39] Company response to PSC 2-3, Attachment 1.
[40] *See* Atmos' response to AG Post-Hearing Data Request item no. 3.
[41] Case No. 2009-00354, direct testimony of Earnest B. Napier, P.E., p. 18. The relevant pages from Mr. Napier's testimony to this effect are attached as Exhibit_(LK-19) to Mr. Kollen's direct testimony in the instant case.
[42] Atmos' response to PSC 2-23 (b): "The Company estimates that the annual PRP O&M savings stands at $110,492 since inception. The $110,492 reflects annual time savings for Leak Surveying Main, Leak Surveying Services, and Leak Revaluation."

projections have consistently been adjusted in only one direction: upwards. Accordingly, the Commission should no longer consider them credible. Importantly, as the Commission considers Atmos' proposed ARM, it need look no further than Atmos' PRP to understand what the Company does when provided the ability to track actual cost recovery without requisite oversight.

The Attorney General believes that over the course of several dockets, it is now well-established that PRP costs are wildly out of control. Moreover, nothing in Atmos' responses to the Commission's three sets of post-hearing data requests changes the fact that by next year, Atmos -- a utility whose customer base has essentially flat-lined -- will have succeeded in doubling its ratebase (currently at $430 million) [43] since the PRP's inception,[44] all through a between-rate cases incremental investment-tracking mechanism specifically designed to minimize Commission oversight. Such an attempt to remake itself as a new utility with entirely new plant is unjustified, unwarranted, and clearly unnecessary. The PRP tracking mechanism has in essence impermissibly shifted the risk of investments from the utility's management and shareholders (where it belongs, pursuant to KRS 278.190) to the ratepayers, and has left the Commission without the requisite level of scrutiny necessary to control cost escalations. Indeed, absent strong action from the Commission, by 2025 Atmos will have invested $3900 for each customer toward *only* the PRP.[45] It has become clear that Atmos truly personifies the idiom that "if you give them an inch, they'll take a mile," except in this matter, Atmos intends to take hundreds of miles.

[43] Waller direct testimony, p. 12.
[44] Kollen direct testimony, pp. 70-75.
[45] Based on Atmos' response to Attorney General's post-hearing data request, item no. 3, and Company's response to PSC 2-18 in Case No. 2017-00349, attached as Exhibit__(LK-18) to the direct testimony of Lane Kollen in the instant case. *See also* Case No. 2017-00308, Atmos' response to AG 1-1.

Therefore, the Attorney General urges the Commission to terminate the PRP tracker, and instead require that costs for pipe replacements be recovered through base rates in the same manner as all other non-gas costs. Doing so allows the Commission to more closely scrutinize capital expenditure projects, and exercise control over costs and operating expenses by examining costs related to pipe projects together with all other costs being reviewed in the context of a base rate case. Alternatively, the Commission should cap the rate of the PRP's growth. In the Company's rebuttal testimony, witness Martin suggested a cap on the PRP of $45 million annually, but also said the Company is willing to consider alternatives.[46] However, during Staff's cross-examination at the evidentiary hearing,[47] Mr. Martin acknowledged that Atmos has never spent more than $45 million annually on the PRP program, and never will even if the program is extended for an additional 5, 10 or 15 years.[48] Atmos thus would prefer to not only continue the PRP, but to do so at the maximum possible level of spending. Atmos' stated willingness to consider a cap is thus disingenuous and lacks any credibility.

In the event the Commission decides to utilize a cap rather than terminating the PRP, the Attorney General urges the Commission to adopt a more substantive and meaningful cap. That cap would include: (1) a maximum of 2% - 3% increase in non-gas revenues each year; (2) placing a cumulative cap on rate increases resulting from the rate mechanism between base rate cases; and (3) including offsets within the PRP that reflect the revenue requirement reductions (savings) resulting from the build-up of accumulated depreciation and accumulated deferred income taxes ["ADIT"] associated with investments in existing plant

---

[46] Martin rebuttal testimony p. 10, referencing Case No. 2017-00308.
[47] VTE at 10:17:48 – 10:23:00.
[48] *Id.*, referring to Atmos' responses to PSC 2-18 (b), and PSC 4-9.

between base rate cases. A reasonable total rate increase cap of 5% would protect customers from the kind of wild, open-ended increases that would occur if the rate of growth in PRP expenditures remains unchecked. This treatment reflects the way these investments would be treated in rate base during a base rate proceeding, and reflects the fact that total plant will continue to depreciate between rate cases.

C. __Return on Equity__

Atmos provided testimony from Dr. James H. Vander Weide, Ph.D. as support for its "conservative" recommendation of a 10.3% return on common equity.[49] Dr. Vander Weide has since upped his ROE recommendation to 10.4% in rebuttal testimony[50], and weeks later again to 10.6%.[51] What is clear from Dr. Vander Weide's involvement in this matter is that his recommendations are anything but "conservative." Dr. Vander Weide's approach consists of either 1) taking outcomes of an analysis and unnecessarily inflating the result, or 2) using analyses that overstate investor expectations for regulated utilities like Atmos, and thus are improper for the Commission's consideration here. These approaches leave Dr. Vander Wiede's recommendations so far outside any zone of reasonableness as to render them useless for the Commission to determine the required ROE in this matter.

In making his ROE recommendation, Dr. Vander Weide used widely accepted and reasonable methods, but modified them in wholly unreasonable ways. For instance, Dr. Vander Weide inappropriately used the quarterly DCF model, thus assuming investors must be compensated for their *ability* to reinvest dividends as if they are received quarterly.[52] Using this version of the DCF model overcompensates Atmos for a decision investors *may* make, at

---

[49] Direct testimony of James H. Vander Weide Ph.D. (Ky. PSC Sept. 28, 2017) at 4.
[50] Rebuttal testimony of James H. Vander Weide Ph.D. (Ky. PSC Feb. 28, 2018) at 28.
[51] Atmos' response to Staff Post-Hearing DR 1-10 (Ky. PSC April 6, 2018).
[52] Direct testimony of Richard A. Baudino (Ky. PSC Jan. 17, 2018) at 33.

the expense of Atmos' customers.[53] Dr. Vander Weide also inflates his DCF results by including flotation costs, even though the Commission has explicitly rejected their use in ROE analyses.[54] Fixing Dr. Vander Weide's DCF analysis by eliminating quarterly compounding and flotation costs revises his testimony DCF ROE rage to 8.8% - 9.3%.[55] The result of Dr. Vander Weide's fixed DCF is much more reasonable, and in line with recent authorized ROEs from other regulatory bodies.[56] Further, Dr. Vander Weide's Risk Premium Model is subject to the same inherent issues as noted in his DCF, wherein he quarterly compounded dividends and included flotation costs.[57] In addition to these mistakes, Dr. Vander Weide's ex-ante risk premium analyses also improperly used forecasted utility bond rates, thus further inflating the results.[58] In Atmos' last rate proceeding, Dr. Vander Weide recommended the Commission employ forecasted bond yields of 6.2%, a completely unreasonable level that never came to pass as actual experience amply demonstrated. [59] Had the Commission used forecasted bond yields in calculating Atmos' ROE, customers' rates would have been higher than necessary to the sole benefit of investors. Importantly, the Commission understands the unnecessary and unreasonable outcome when ROEs are set exclusively using analysis utilizing forecasted interest or bond rates. Specifically, just months ago the Commission agreed, "models supporting the low interest rate should be given more weight than those supporting high interest rate expectations."[60] To provide the Commission an additional data point as to how unreasonable Dr. Vander Weide's inflated analyses are, consider that using a

---

[53] *Id*.
[54] *See* AG Hearing Exhibit 7 at 28; Baudino direct testimony at 33.
[55] Baudino direct testimony at 33.
[56] VTE at 11:44:00- 11:51:00.
[57] Baudino direct testimony at 34-35.
[58] Baudino direct testimony at 35.
[59] Baudino direct testimony at 36.
[60] AG Hearing Exhibit 7 at 28.

more reasonable, and more current, bond yield provides for an ex-post risk premium return on equity range of between 7.81%-8.41%, which is more than 200 basis lower than Dr. Vander Weide's current recommendation.[61]

Dr. Vander Weide's pattern of inflating the "required" ROEs carries over into his CAPM analyses as well. In addition to his aforementioned penchant of using forecasted interest rates, Dr. Vander Weide inappropriately added a size premium to his CAPM outcome.[62] Dr. Vander Weide's use of a size premium to bump-up his ROE recommendation is based upon studies of unregulated companies and their betas, while he provides no evidence that regulated companies like Atmos need any added ROE adjustment to accommodate for their smaller size.[63] The use of a size premium merely overstated Dr. Vander Weide's recommended ROE, as there is no evidence that investors expect or require this sort of additional premium for low-risk regulated utility companies. As Mr. Baudino noted on page 40 of his Direct Testimony, excluding unreasonable additions such as an inflated and arbitrary 0.90 beta, forecasted treasury yields, and flotation costs, renders Dr. Vander Weide's DCF-based CAPM at a much more reasonable and market-based 9.48%.[64]

In addition to providing the Commission a considerate critique of Dr. Vander Weide's Direct Testimony, Attorney General witness Mr. Baudino also prepared testimony on a reasonable ROE for Atmos. Mr. Baudino's testimony is in agreement with the Commission's position that flotation costs are most likely already reflected in current stock prices, to the extent that they are even accounted for by investors, as well as the fact that current interest

[61] Baudino direct testimony at 37; *see also* Atmos' response to Staff Post-Hearing DR 1-10.
[62] Vander Weide direct testimony at 38.
[63] Baudino direct testimony at 38-39.
[64] Baudino direct testimony at 40.

rates should carry more weight than arbitrary forecasted rates.[65] Mr. Baudino's recommended ROE is 8.8% based on his DCF analysis, and supported by his CAPM.[66] This recommendation is based on market data and with a single exception, Mr. Baudino employed the same proxy group as Dr. Vander Weide, providing the Commission an apples-to-apples perspective.[67] Mr. Baudino's use of the DCF model is appropriate, as evidenced by the Commission's previous consideration of the model as well as Mr. Vander Weide's use of it in this matter.[68] Mr. Baudino's recommendation is based on the fact that, "The U.S. economy continues to operate in a low interest rate environment."[69] Mr. Baudino made his recommendation with an understanding that the Federal Reserve has indicated it may raise rates in the future, but importantly, the Federal Reserve only controls short-term Federal Funds Rates.[70] The impact on long-term rates, utility bond yields and utility stocks from the Federal Reserve's increase of short-term interest rates do not necessarily correspond.[71] Although the Federal Funds rate has been steadily rising in recent years, long-term rates and average utility bond yields have fluctuated.[72] In fact, although the Federal Funds rate was raised throughout 2017, the 20-year Treasury rate started 2017 at 2.75% and dipped as low as 2.53% in September, while the average utility bond rate started in January 2017 at 4.24% and decreased to 3.88% in November.[73] The Commission should take note that although the Federal Reserve plans to increase the Federal Funds rate in 2018, market data will inevitably determine its actions and the impact of any increase may not necessarily lead to higher long-

---

[65] Baudino direct testimony at 34-35; AG Hearing Exhibit 7 at 28.
[66] Baudino direct testimony at 3.
[67] *Id.*
[68] *See* Case Nos. 201-00179, 2016-00370, 2016-00371, 2013-00148, 2010-00116.
[69] Baudino direct testimony at 9.
[70] Baudino direct testimony at 7.
[71] *See* Baudino direct testimony at 9-11.
[72] *Id.* at 10.
[73] *Id.*

term or utility bond yields. As such, the Commission should continue to give more weight to ROE analyses that depend on current market rather than forecasted rates that may never come to fruition.

The Attorney General recommends the Commission adopt Mr. Baudino's 8.8% ROE and accordingly reduce Atmos' revenue requirement by $3,972,019.

D. Attorney General's Proposed Revenue Requirement Adjustments

1. RATE BASE ISSUES

a. 12% Growth Rate of Non-PRP Plant Additions is Unacceptable and Should be Reduced

Atmos bases its forecast of gross plant based in part upon capital spending projections from the last quarter of the prior fiscal year, and for the final six months of the test year, upon a twelve percent increase to the previous year's budget.[74] However, Atmos has never identified any projects for the proposed increase in capital spending. The Company then added these capital expenditures to gross plant and reflected the 13-month average in ratebase, and calculated depreciation expense on the plant additions, which it included in depreciation expense. Atmos also calculated the related increases in accumulated depreciation and ADIT and reflected the 13-month averages as subtractions from ratebase.

Atmos use of a 12% escalation rate is excessive because it is four-to-six times greater than commonly-accepted inflation estimates of 2% - 3%. It is highly unusual that the Company failed to identify any projects for which the projected increase is intended. As pointed out by Mr. Kollen, if a rate increase is granted based on an assumption, the Company

[74] Waller direct testimony, p. 12.

is under no obligation to spend these sums – it simply retains the additional revenue.[75] Rather, the Commission should reject the proposed escalation rate, and instead reflect the same level of capital expense for the last six months of the test year as was reflected in Atmos' most recent capital expenditure budget. This adjustment would reduce the revenue requirement by $75,000.[76]

b. Accumulated Deferred Income Taxes and Temporary Differences (Liabilities) Subtracted from Ratebase are Understated, and Should be Increased

The TCJA's reduction of the federal income tax rate from 35% to 21% also had the effect of reducing the deferred income tax expense to reflect the amortization of the excess ADIT. Since this reduction in the tax rate permanently reduces future liabilities for this expense, the "reduction in the net ADIT liability is termed 'excess' ADIT and is considered a regulatory liability for generally accepted accounting principles ("GAAP")."[77] Consequently, the excess ADIT is amortized as a negative deferred tax expense.[78] Mr. Kollen recommended a reduction of $2.935M to reflect the reduction in income tax expense to amortize excess ADIT.[79]

The Company's position, put forward through Ms. Story's testimony, is that all excess ADIT should be treated as protected and returned to customers over a twenty-four (24) year amortization period, since the Company proposes to use the alternative normalization method, Reverse South Georgia (the "alternative method").[80] Under the provisions of the TCJA, protected excess ADIT must be returned according to the applicable methodology as

[75] Kollen direct testimony, p. 8.
[76] Kollen direct testimony, p. 8.
[77] Kollen direct testimony, p. 48.
[78] *Id*.
[79] *Id*. at 5, 49.
[80] Story Rebuttal, at 46–47; VTE at 3:22:00–3:24:30.

proscribed in the Act.[81] Unprotected excess ADIT, or those ADIT that are not considered "protected" under the TCJA, can be returned over whatever time period the Commission prescribes. The Company maintains that a normalization violation will occur if it amortizes protected excess ADIT over a shorter time than the prescribed normalization method of accounting.[82]

In its response to the Attorney General's post-hearing data request, the Company provided a breakdown of excess ADIT between those which are property-related and those which are not.[83] Property-related excess ADIT totals $37,398,689, while non-property related excess ADIT totals $2,089,093.[84] As Mr. Kollen suggests, the Attorney General recommends that these funds be returned over a five-year amortization period.[85] The Commission should refuse to amortize the excess unprotected ADIT over the amortization period proposed by Atmos, as it is unnecessary and unreasonable. The Commission should return these funds to customers as soon as possible, and the Attorney General accordingly recommends a five-year amortization period.

i. DTA Due to NOL Temporary Difference Should be Excluded from Ratebase

Accumulated deferred income tax assets ("DTAs") and accumulated deferred income tax liabilities ("DTLs") are both recognized for ratemaking purposes. Generally, DTLs are subtracted from ratebase since they represent cost-free capital to the utility, while DTAs are usually added to ratebase because the utility must finance these costs.[86] The Company can

[81] TCJA § 13001 (d).
[82] Story Rebuttal, at 42.
[83] Atmos' Response to Attorney General's Post-Hearing Data Request, item no. 4.
[84] *Id.*
[85] VTE at 4:41:41 – 4:42:40.
[86] Kollen Direct, at 9 (Mr. Kollen also noted that "there are exceptions to this general ratemaking practice if the related costs are not included in the revenue requirement").

overstate the ratebase and revenue requirement if it improperly adds certain DTAs to rate base—leading to an understatement of the net ADIT amount subtracted from ratebase—or if it correctly adds certain DTAs to ratebase but fails to properly subtract the equivalent liabilities, or temporary differences that led to those DTAs.[87] DTAs are the amounts of prepaid income tax that the federal and state governments will refund to the utility in the future.[88] DTLs are the amounts of deferred income tax that the utility will pay to federal and state governments in the future, and reflect the ADIT expense.[89] The DTLs "represent the tax effects of temporary, or timing, differences where income is deferred or deductions are accelerated on the income tax returns compared to the recognition of income and expenses for accounting purposes."[90]

Mr. Kollen noted a number of DTAs and related temporary differences that the Company improperly included in ratebase.[91] Regarding the first category of errors Mr. Kollen explained that:

> [i]n general, these DTAs are related to costs that are not recovered through the ratemaking process. None of the costs giving rise to these DTAs are included in operating expenses or subtracted from ratebase in the determination of the revenue requirement. Thus, neither the DTAs should be added to ratebase nor the temporary differences subtracted from rate base.[92]

Mr. Kollen stated that as to the second category of errors he identified, the Company "failed to subtract from ratebase the related temporary differences that gave rise to the DTAs", which "violates the basic ratemaking principle of matching benefits and costs."[93]

---

[87] *Id*. at 10.
[88] *Id*.
[89] *Id*.
[90] *Id*.
[91] *Id*. at 11–13.
[92] *Id*. at 13.
[93] *Id*. at 14.

Mr. Kollen went on to note that the Company agrees with the exclusion of certain DTAs from rate base, namely those in the first category of errors.[94] This first category of revenue requirement reductions recommended by Mr. Kollen, and agreed to by the Company, totals $119,587.[95] Mr. Kollen further recommended reductions to the revenue requirement from the second category of errors, with which the Company did not agree, totaling $608,340.[96] The Company argues that these DTAs should remain in ratebase because the associated expenses are included in operating income. While the expenses are indeed included in the revenue requirement, Mr. Kollen explains that this is not enough to justify the DTAs' continued inclusion in ratebase, since the accompanying liabilities from delayed payment of the expense must also be subtracted from the ratebase.[97] Without the liabilities which gave rise to the DTAs being subtracted from ratebase, the DTAs cannot also be included.[98] Therefore, the Attorney General recommends that the Commission accept Mr. Kollen's adjustment as to the DTA due to the NOL Temporary difference in both categories of errors he identified, thereby removing them from the Company's ratebase.

ii. NOL Carryforward

In Atmos' last rate case,[99] the Company projected a net operating loss in the test year. Accordingly, the entirety of the income tax expense reflected in the revenue requirement was deferred income tax expense. In that case, the Company argued that it somehow had reduced the deferred income tax expense for the effects of the NOL carryforward and thus, was entitled to include the asset NOL ADIT in ratebase due to the alleged reduction in income tax

[94] *Id*. at 15.
[95] *Id*. at 16–17.
[96] *Id.* at 17–18.
[97] *Id*. at 16.
[98] *Id*. at 16.
[99] Case No. 2015-00343.

expense. The AG disagreed with the Company's position in that case because the Company made no specific adjustment to reduce the deferred income tax expense in that case and the Commission never made any specific adjustment for this purpose.[100]

As a result, Atmos customers previously paid the entirety of the income tax expense without reduction for the NOL in the revenue requirement, and paid the carrying charges for the expense due to the addition of the NOL ADIT to ratebase. Such a result is highly inequitable for Atmos' customers.

In the current proceeding, Mr. Kollen recommended that this asset NOL ADIT be excluded from the Company's ratebase.[101] In an attempt to find a reasonable compromise between the Company and the Attorney General, at hearing, Mr. Kollen proposed that the revenue requirement for the NOL ADIT be included in a rider that would decline each year as the NOL carryforward is utilized and the balance of the NOL ADIT declines to zero within the next 3–5 years.[102] This compromise will ensure fairness to the customers who must pay this expense over the remaining life of the asset. Regardless, the treatment proposed by Atmos in its Application is inequitable to customers as it requires them to pay twice for the same item.

Although Atmos witness Ms. Story opposed the Attorney General's rider alternative, the IRS Consistency Rule ["the Rule"][103] does not require: 1) that the NOL asset ADIT be added to ratebase, 2) that the NOL asset ADIT revenue requirement cannot be separated from the base revenue requirement and included in a rider, or 3) that rider rates cannot be reduced

---

[100] Kollen Direct, at 21.
[101] Kollen Direct, at 30; VTE 4:33:55–4:34:20.
[102] VTE 4:33:55–4:37:00.
[103] 26 C.F.R. § 1.167(l)-1 ["Limitations on Reasonable Allowance in Case of Property of Certain Public Utilities"]; see also the Attorney General's responses to the Commission Staff's post-hearing data requests, item no. 2.

as the NOL asset ADIT declines to $0 due to the utilization of NOL carryforwards in future years. Atmos' Hearing Exhibit 1 provided revised schedules and workpapers showing the calculation of income tax expense separated into current income tax expense and deferred income tax expense. That exhibit includes the modified filing Schedule B.5.F, Schedule C.1, and Schedule E that were introduced by Mr. Waller in Rebuttal Exhibit GKW-R-1_FINAL with a further modification to Schedule E to reflect the State and Federal Income Tax Expense effects of the Company's revised rate increase request of $3.213 million. Atmos Hearing Exhibit 1 depicts that the projected State and Federal Income Tax Expense is $8.014 million, including the computed taxes on the proposed increase. It shows that the NOL asset ADIT will be reduced by $6.731 million and other liability ADIT deferred tax amounts will be increased by $1.283 million. In other words, the current income tax expense would be $6.731 million, but for the NOL carryforward and the ability to use that to reduce the current income tax expense to $0. At that rate, the NOL ADIT would be reduced to $0 within the next 4 years. Thus, the return on the NOL ADIT, if it is included in ratebase, should decline to $0 over the next 4 years. If the Commission allows the NOL ADIT in ratebase in the base revenue requirement without any provision for reduction in the revenues recovered from customers concurrent with the reduction in the NOL ADIT as the NOL carryforward is utilized, then the Company will recover millions of dollars annually in excess of its actual costs. In other words, rates necessarily will be unjust and unreasonable given that the NOL ADIT is temporary and will decline to $0 within the next few years.

The Rule specifies the methodology for the matching of deferred tax expense and the related ADIT and describes formulaically how to do that with a historic test year, future test year, or blended test year. The Rule, by its terms, is limited to the depreciation-related deferred tax expense and the related ADIT reserve. The Rule includes no reference to NOL ADIT. Even if the Rule could be read to require that the NOL asset ADIT be included in ratebase when setting rates in a rate case, which it does not, there is nothing in it that precludes the Commission from reducing rates in the future as the NOL asset ADIT declines to $0. The relevant portion of the rule is presented and highlighted in Mr. Kollen's response to the Commission Staff's post-hearing data requests, item no. 2. That excerpt addresses the change in the depreciation-related ADIT subtracted from ratebase in conjunction with the depreciation-related deferred income tax expense in the forecast test year. The Company's revised revenue requirement and the hearing exhibit demonstrate that both amounts were calculated consistently and therefore in compliance with the Rule. Whether the NOL ADIT is included in ratebase in the base revenue requirement or not, or is included in a rider is irrelevant to the specific requirements of the Rule.

Finally, it should be noted that under the alternative rider proposal, which the Attorney General believes could be a reasonable outcome for the Commission, there is no change in the revenue requirement related to the depreciation-related deferred income tax expense and no change in the related ADIT subtracted from ratebase in the forecast test year.

c. Cash Working Capital is Overstated and Should be Reduced to Reflect the Lead/Lag Study's Corrected Results

Based on the 1/8th O&M expense methodology, Atmos calculated its cash working capital ["CWC"] allowance of $3.271 million. However, in compliance with its commitment in the last rate case, Atmos also produced a lead-lag study in the instant case which calculated an investment of $2.4 million. Additionally, Atmos incurred no incremental costs for the study.

As Mr. Kollen pointed out, lead-lag studies provide a much more accurate measurement of leads and lags in a utility's operating *cash* flows.[104] Properly performed lead/lag studies measure the timing of *cash* receipts for revenues or *cash* disbursements for expenses, and thus, the investment required by investors or customers. Lead-lag studies measure the average *cash* investment provided by either investors (positive) or customers (negative) over the course of the study period. Correctly performed lead-lag studies do not include non-cash expenses, such as depreciation and deferred income tax expenses, because the return on the delayed recovery of these expenses is reflected in the return on ratebase. The net accumulated depreciation and accumulated deferred income taxes are subtracted from ratebase, but only on a lagged basis. This allows the Company to retain the carrying charge value of these non-cash expenses between rate cases.

Yet on the other hand, as Mr. Kollen points out, the outdated one-eighth of O&M expense methodology:

> ". . . fails to measure the timing of cash receipts for revenues or cash disbursements for expenses. It is based on a simplistic formula that may have been appropriate when adopted by the FERC in the early 20th century, but is no longer appropriate given the availability of data and the ability of computer-based calculations."[105]

In this case, however, Atmos did not perform the lead-lag study properly. Had it been performed correctly, the study would have revealed a *negative* \$3.553 million cash working capital investment, not the *positive* \$2.4 million Atmos claims. The Company incorrectly included \$5.953 million of non-cash expenses in the calculation of the cash working capital investment, broken down as: deferred federal income tax expense (\$1.087 million); deferred

[104] Kollen direct testimony, p. 31.
[105] Kollen direct testimony, pp. 36-37.

state income tax expense ($0.069 million); depreciation expense ($2.307 million); and return on equity ($2.490 million).

Not only did Atmos improperly perform the lead-lag study in the current case, but as Mr. Kollen points out, it failed to perform them properly in some of its *other* operating jurisdictions, as well, including Texas, Virginia, Tennessee, and Colorado.[106] In every lead-lag study filed in those jurisdictions, when those studies are correctly calculated they result in negative cash working capital, just as is the result for the Kentucky lead-lag study.[107] In other jurisdictions, Atmos properly reflected only the cash operating expenses.

Additionally, if the Commission adopts Mr. Kollen's recommendation, it should also make one additional adjustment, one with which Atmos agrees:[108] prepayments need to be removed from ratebase because the lead-lag approach to CWC already includes the effects of prepayments.[109]

The Commission should set Atmos' CWC at negative $3.553 million, which is a reduction of $6.823 million when compared to Atmos' proposed CWC of $3.271 based on the one-eighth expense methodology. The effect reduces the revenue requirement by $0.826 million using the Company's proposed rate of return, and the new income tax rate of 21%. This includes the effect on ratebase of using the corrected CWC study results and removing the prepayments to avoid double counting the ratebase effects.[110]

---

[106] Atmos provided results of the lead-lag studies performed in its other jurisdictions in its response to AG 1-10 in Case No. 2015-00343, and to AG 1-30 in the instant case.
[107] Kollen direct testimony, pp. 30-37.
[108] Direct testimony of Joe T. Christian at 15-16.
[109] *Id*. at p. 36.
[110] *Id.* at 36-37.

d. Proposed Regulatory Asset for Rate Case Expense Should be Disallowed

In the instant case, Mr. Kollen recommended that the Commission reduce Atmos' base rates by $16.937 million.[111] As Mr. Kollen describes, it was inappropriate for Atmos to have filed this case in the first place because the requested rate increase is driven by: an excessive return on equity; failure to include the annualized effect of new debt issued to replace a maturing long term debt issue at less than half the interest rate of the old debt; unreasonable and unrealistic increases in forecast gross plant additions; failure to make appropriate ratemaking adjustments to reduce ratebase for various income tax-related costs (unrelated to the federal income tax rate reduction); failure to use a reasonable calculation of cash working capital; unreasonable and unrealistic increases in forecast O&M expenses compared to actual expenses; failure to remove all incentive and stock-based compensation expense; failure to remove excessive retirement plan expenses; and unreasonable and unrealistic increases in forecast ad valorem tax expense compared to actual expenses.

In short, not only does Atmos not need additional new revenues, its present revenues must be reduced to limit overearnings in the test year. The company should not be incentivized to file such rate cases by allowing it to charge ratepayers for rate case expense, when the case was not brought in good faith. Accordingly, the Commission should deny Atmos' request for $0.314 million in rate case expense both in ratebase and in amortization expense, for which it sought a two-year amortization.

[111] Kollen direct testimony, p. 4. When accounting for the interim rate reduction provided in Case No. 2018-00039 of $5.6 million due to savings resulting from the TCJA, Mr. Kollen's revised recommendation would be that Atmos' base rates be reduced by $11.337 million.

2. OPERATING INCOME ISSUES

a. Forecasted O&M Expense for both the Kentucky Division and the Kentucky/Mid-States Division is Excessive, Should be Reduced

In comparing forecast O&M expenses for the Kentucky Division with actual historic expense levels, Mr. Kollen found several irregularities. In particular, the company is replacing its leased vehicles, resulting in an increased expense to $1.018 million from the historic $0.823 million (an increase of $0.195 million); and outside services increasing to $2.971 million from $2.603 million (an increase of $0.368 million).[112] Curiously, Atmos provided no support or rationale for the increases. Therefore, the Commission should remove the forecast increases in these two items.

Mr. Kollen performed a similar review of forecast O&M expenses for the Kentucky/Mid-States Division, and found additional irregularities, in particular increases in: telecom expense to $0.263 million from $0159 million (an increase of $0.104 million); travel and entertainment to $0.292 million from $0.212 million (an increase of $0.80 million); and outside services to $1.984 million from $1.336 million (an increase of $0.648).[113] For all three categories of expense – telecom, travel and entertainment, and outside services – the Company also forecasted an increase in the same type of expense, albeit in a slightly different amount, for the Kentucky Division. However, for all three expense categories, the Company failed to include an offset in the Kentucky/Mid-States Division with any reduction in the Kentucky Division. The Company's rationale for all three expense types thus does not support significant increases in the Kentucky/MidStates Division when there also is an increase in

[112] Kollen direct testimony, pp. 39-40.
[113] *Id.*, pp. 41-42 (citing Company's response to AG 1-23, Attachment 2 Part B).

the forecast expense for the Kentucky Division. Therefore, the Commission should remove the forecast increase in these expense categories.

b. Directors' Stock Expense Should be Disallowed

Atmos is seeking rate recovery for approximately $0.345 million of a deferred stock compensation plan allocated from the corporate general office division (002).[114] This expense is tied directly to Atmos' stock price. When incentive compensation tied to financial performance is included for rate recovery, company management becomes incentivized to seek greater and more frequent base rate increases. Clearly, this would present a conflict between achieving lower rates for ratepayers, and enhancing financial performance.

The Commission has disallowed and removed all incentive compensation expenses from the revenue requirement when it is incurred to enhance shareholder goals.[115] The Attorney General urges the Commission to do likewise in the instant case.

c. Retirement Plan Expense is Excessive

Atmos has many employees who participate in both a defined benefit plan, and a defined contribution plan (usually a 401K plan). Atmos provides a matching contribution to the defined contribution plan. In recent utility rate cases, the Commission has disallowed test

---

[114] Kollen direct testimony, p. 44, *citing* Atmos' response to AG 2-4 (a copy of which is attached to the direct testimony of Lane Kollen as Exhibit__(LK-11).

[115] *See, e.g., In Re* Electronic Application of Duke Energy Kentucky, Inc. for: An Adjustment of the Electric Rates, etc., Case No. 2017-00321, Final Order dated April 13, 2018, pp. 20-22; *In Re* Kentucky-American Water, Case No. 2010-00036, Order dated Dec. 14, 2010, p. 37; and *In Re* Atmos Energy Corporation, Case No. 2013-00148, Order dated April 22, 2014, pp. 19-20 ("Incentive criteria based on a measure of EPS, with no measure of improvement in areas such as safety, service quality, call-center response, or other customer-focused criteria, are clearly shareholder-oriented. . . . the Commission has long held that ratepayers receive little, if any, benefit from these types of incentive plans. . . It has been the Commission's practice to disallow recovery of the cost of employee incentive plans that are tied to EPS or other earnings measures.").

year matching contributions to 401K plans for rate recovery, where the company has both types of plans.[116]

Atmos' response to AG 2-25 stated that the figures presented in response to PSC 1-65 and PSC 2-24 [117] present the best data to estimate test year expense regarding the level of Company contributions to the defined contribution plan, for those employees who also participate in the defined benefit plan. Excluding those contributions results in a reduction of retirement plan expense of $0.575 million, and a reduction in the revenue requirement of $0.579 million. This includes the retirement plan expense that the Kentucky rate division incurs directly, and the expense allocated to Kentucky for ratemaking purposes from the SSU and Kentucky/Midstates divisions for their employees.[118]

d. Forecasted Income Tax Expense Should be Reduced to Reflect New Federal Income Tax Rate of 21%

Atmos' application was filed prior to the enactment of the TCJA. Mr. Kollen's direct testimony, however, was filed after the passage of the TCJA and addressed the law's changes, ultimately providing recommended adjustments to reflect the lower level of expenses.[119] Mr. Kollen stated:

> There are three direct effects based on the Company's income tax expense and ADIT. First, there is a reduction in current and deferred federal income tax expense included in the test year. Second, there is a reduction in deferred income tax expense to reflect the amortization (through negative deferred income tax expense) of the excess accumulated deferred income taxes ("ADIT). Third, there is a reduction in the gross revenue conversion factor. [120]

---

[116] *See, e.g., In Re* Electronic Application of Kentucky Utilities for an Adjustment of its Electric Rates, etc., Case No. 2016-00370, Order dated June 22, 2017, p. 14-15; and *In Re* Application of Cumberland Valley Electric, Inc. for a General Adjustment of Rates, Case No. 2016-00169, Order dated Feb. 6, 2017, p. 10.
[117] *See* especially the supporting data provided in the Company's confidential response to PSC 2-24.
[118] Kollen direct testimony p. 46 (*citing* responses to PSC 1-65, PSC 2-24, PSC 3-11, and AG 2-25, copies of which are attached as Exhibit_(LK-12) to Mr. Kollen's direct testimony).
[119] *See generally* Kollen direct testimony.
[120] Kollen direct testimony, at 47.

Regarding the first effect of the TCJA, Mr. Kollen further opined that "[t]he current and deferred federal income tax expense is simply scaled down to reflect the 21% federal income tax rate instead of the 35% rate used to calculate the expense in the test year."[121] His reduction to the revenue requirement to account for lower expenses due to the tax rate change equals $6.796M.[122] The Commission should accept Mr. Kollen's adjustment to reflect this reduced tax expense going forward.

On February 27, 2018, the Attorney General and the Company submitted an Interim Settlement Agreement ("Agreement") in the parallel tax case.[123] The Agreement produced an annual reduction of about $4.6 million in base rates (an approximate 5.6% annual reduction), and approximately $1 million in the PRP (for an approximate 9.7% reduction).[124] The Attorney General and the Company did not agree on the proper methodology to be used in calculating the total impacts of the reduction in tax rates, which was deferred for decision in this rate case.[125] Thus, the Commission has already approved the Federal Income Tax reduction on an interim basis, and should likewise approve a permanent reduction in this matter. Apart from the correct methodology to be used in calculating the tax reduction (*i.e.,* the NOL should not have been reduced in the prior period), the Commission also needs to address the larger Net Operating Loss Carryover issue, which was not part of the Agreement.

e. Forecasted Ad Valorem Tax Expense is Excessive and Should be Reduced

[121] *Id*. at 48.
[122] *Id*. at 5, 49.
[123] *In Re* Electronic Investigation of the Impact of the Tac Cuts and Jobs Act on the Rates of Atmos Energy Corporation, Case No. 2018-00039.
[124] *Id*. at pp. 2–4.
[125] *Id.* at 2.

Atmos' actual incurred ad valorem tax expenses have been declining for each of the past three years, including allocations from the Kentucky/Midstates and the SSU Divisions for ratemaking purposes. Its ad valorem tax expenses were $5.721 million in fiscal year 2015, $5.127 million for fiscal year 2016, and $4.534 million for fiscal year 2017.[126] In fact, the company's ad valorem expenses have been declining despite the fact that its plant balances have continued to increase.[127]

It is therefore unreasonable and impossible to explain why the Company applied an *8%* escalation to its 2018 forecast ad valorem expense, for a total of $5.073 million.[128] Atmos' rationale for the 8% escalation factor focuses solely on its budget estimate -- it simply fails to justify the requested expense for ratemaking purposes, especially when compared to the Company's actual ad valorem tax expense and historic growth. [129] Therefore, the Commission should reject Atmos' forecast ad valorem tax expense and instead adopt a forecast based on actual expense for the fiscal year ending 2017, which was $4.534 million. The effect reduces forecast ad valorem tax expense of $0.539 million, and reduces the revenue requirement by $0.543 million.

f. Amortization Expense for Deferred Interest Should be Included

Atmos has a senior note in the sum of $450 million that will mature on March 15, 2019.[130] That date falls within the fully-forecasted test year. As Mr. Baudino testified both in

---

[126] Kollen direct testimony, pp. 50-51 (*citing* Atmos' response to AG 1-24, attached as Exhibit _(LK-13) to his direct testimony).
[127] *See* Atmos' response to AG 1-24, attachment 4. Atmos' net plant balances were $459.421 million as of December 31, 2014; $506.208 million as of December 31, 2015; $553.636 million as of December 31, 2016; and $604.160 million as of September 30, 2017. These sums include allocations from the Kentucky/Midstates and SSU Divisions for ratemaking purposes.
[128] Atmos' response to AG 1-24, attachment 1.
[129] Kollen direct testimony, p. 51 (*citing* Atmos' response to AG 2-7, attached as Exhibit_(LK-14) to his testimony).
[130] *See* Baudino direct testimony, p. 30.

his direct testimony[131] and during the evidentiary hearing,[132] it is reasonable to assume that Atmos will refinance this debt issue at a significantly lower interest rate. Mr. Baudino noted that according to Moody's Credit Outlook as of December 29, 2017, the average long-term utility bond yield was 3.81%, and for purposes of this case, assumed the refinance rate would be 4.0%. Mr. Baudino recommended that the 4.0% cost of the refinancing be included within the long-term debt component of Atmos' capital structure, and that the 8.5% cost of the maturing issue be excluded from the cost of debt.[133] Both Messrs. Baudino and Kollen recommend that the 4.0% interest rate be annualized through the entire fully forecasted test period. Doing so, however, would cause the Company to temporarily under-recover its cost of debt for a portion of the test year. Therefore, Mr. Kollen recommends that the Commission allow the Company to defer the differential in the interest expense between the maturing issue and the new debt issue and to amortize that expense in the revenue requirement over a ten-year period.[134] This would increase the revenue requirement by $0.136 million.[135] The Attorney General agrees with Mr. Kollen and Baudino on this matter.

g. Depreciation Expense Should be Reduced to Reflect Lower Capital Expenditures and Plant Additions, and Net Salvage Costs

As Mr. Kollen explains in his direct testimony, net salvage refers to the cost of removal, less salvage income, to retire and remove an asset from service. Actual net salvage is always charged against (used to reduce) accumulated depreciation (if there is net negative salvage, here cost of removal exceeds salvage income) or to increase accumulated depreciation (if there

[131] *Id.*
[132] VTE beginning at 3:55:00.
[133] Baudino direct testimony, p. 30; Kollen direct testimony, p. 53.
[134] Kollen direct testimony, pp. 53-54.
[135] *Id.* As Mr. Kollen notes, this recommendation should be adopted only if the Commission adopts the AG's recommendation to annualize the cost of the new debt issue and remove the cost of the old debt issue.

is net salvage, where salvage income exceeds cost of removal).[136] Mr. Kollen further explains that the three different approaches to how net salvage is reflected in depreciation rates revolve around timing. With all three approaches, the utility recovers all of its plant costs including net salvage.[137]

The first approach, which Atmos utilizes, estimates and preemptively reflects future net salvage in depreciation rates and expense. This approach results in greater depreciation rates in the earlier years of asset lives and lower depreciation rates in the latter years of asset lives compared to the second or third ways, all else equal. The second approach includes no estimate of future net salvage in depreciation rates. Instead, the net salvage is included in the depreciation rates and expense on a lagged basis. This approach results in lower depreciation rates in the earlier years of asset lives and greater depreciation rates in the latter years of asset lives compared to the first or third approaches, all else equal. Finally, the third approach is a compromise position between the first two approaches, as it includes net salvage at a level based on recent actual net salvage. Thus, the third approach provides relatively contemporaneous recovery of actual net salvage rather than the first approach's preemptive recovery, or the second approach's lagged recovery. This third approach results in lower depreciation rates in the earlier years of asset lives and greater depreciation rates in the latter years of asset lives compared to the first approach, and greater depreciation rates in the earlier years of asset lives and lower depreciation rates in the latter years of asset lives compared to the second approach, all else equal.[138]

---

[136] Kollen direct testimony, p. 55.
[137] *Id.* at p. 57.
[138] Kollen direct testimony, pp. 55-56.

Atmos' current depreciation rates were adopted in its last rate case, Case No. 2015-00343, based upon a settlement reached between the parties, which the Commission approved in its entirety.[139] The depreciation rates in the settlement pertaining to that case were proposed in conjunction with all other issues pertaining to that case.[140] In those depreciation rates, the Company included net salvage based on *forecasts* of future cost of removal and salvage income, or the above-described "first approach." [141]

Atmos' current methodology regarding the treatment of net salvage is inappropriate because it front-loads forecasted costs based on limited data applied to the entirety of each plant account, thus preemptively recovering costs that have not and may not be incurred. This methodology thus overstates depreciation rates and expense. Therefore, the Attorney General urges the Commission to modify Atmos' depreciation rates to utilize the above-described third approach, which provides contemporaneous recovery of net salvage dollars. This methodology: (i) calculates the net salvage based on the same historic data used by the Company, but uses the average actual annual historic net salvage dollars divided by the gross plant in each plant account rather than by the average actual annual retirements; and (ii) assumes that the net salvage will continue at the same dollar amount until the next depreciation study. The effect reduces the revenue requirement by $3.430 million, comprised of the reduction in depreciation expense of $3.531 million (grossed-up from $3.507 million),

[139] Case No. 2015-00343, Final Order dated Aug. 4, 2016.
[140] Case No. 2015-00343, Final Order dated Aug. 4, 2016, Appendix A ("Stipulation"), § 21 provides: "This Settlement Agreement is submitted for purposes of this case only and is not deemed binding upon the parties hereto in any other proceedings, nor is it to be offered or relied upon in any other proceeding involving Atmos or any other utility."
[141] The depreciation rates set established in Case No. 2015-00343 are set forth in Exhibit 2 to the Stipulation entered in that case. *See also* Atmos' response to Attorney General's Post-Hearing Data Requests, item no. 2.

offset by the return on the increase in capitalization of $0.101 million due to the reduction in accumulated depreciation.

Additionally, as outlined throughout this brief, since Mr. Kollen's adjustments reduce the Company's projected capital expenditures, corresponding reductions to depreciation expense should also be made, which reduce the revenue requirement by an additional $0.021 million.[142]

3. RATE OF RETURN ISSUES

a. Quantification of AG's Recommendation for Cost of Long-Term Debt

Mr. Kollen has calculated a revenue requirement reduction of $1.089 million based on Mr. Baudino's recommendation [143] that the Commission include the 4.0% annualized cost of the new debt issue and exclude the 8.5% annualized cost of the maturing debt issue.[144] The Attorney General recommends the Commission make these adjustments.

b. Quantification of AG's Recommendation for Cost of Short-Term Debt

Mr. Baudino recommended [145] that the Commission remove commitment and banking fees from the Company's proposed cost of short-term debt, and that they instead be included in operating expenses. This recommendation reduces the cost of short-term debt from 1.99% to 0.92%, which reduces the revenue requirement by $0.150 million.[146] Moving these fees to operating expenses increases operating expenses by $135,408.[147]

Additionally, the Company currently includes these fees in the cost of short-term debt used in AFUDC on CWIP. These fees should not be included in the cost of short-term debt

[142] Kollen direct testimony, p. 54.
[143] Baudino direct testimony, p. 30.
[144] Kollen direct testimony, pp. 61-62.
[145] Baudino direct testimony, pp. 29-30.
[146] Kollen direct testimony, p. 62.
[147] Kollen direct testimony, p. 60.

used for AFUDC to avoid double counting and double recovery of the costs.[148] These adjustments are reasonable and the Commission should make them accordingly.

c. Quantification for AG's Recommendation for Return on Equity

As discussed previously, Mr. Kollen has calculated that Mr. Baudino's recommendation[149] to set Atmos' ROE at 8.8% reduces the Company's revenue requirement by $3.972 million.[150]

3. COMPOSITE FACTORS FOR DIVISIONS 002 (Corporate Office Division) and 091 (Kentucky/Mid-States Division)

Atmos' shared services costs are allocated through the use composite factors. Costs incurred at the corporate office division are allocated to the Kentucky/MidStates Division in the filing using one composite factor, while costs allocated from the corporate office division to the Kentucky/MidStates Division, together with costs incurred directly by the Kentucky/MidStates division, are subsequently allocated to Kentucky using another composite factor. Atmos calculates the composite factors using three equally-weighted components for each division that receives an allocation of its costs: (a) gross direct property plant and equipment; (b) average number of customers; and (c) total O&M expense.[151]

Atmos uses various versions of the composite factor, *e.g.,* all companies, utility, and regulated only, among others, to allocate costs from the Corporate Office Division. In the filing, Atmos calculated a composite factor of 10.35% and allocated costs from Division 002 to Division 091 using this factor. Atmos calculated a composite factor of 50.25% and allocated

---

[148] Kollen direct testimony, pp. 60-61.
[149] Baudino direct testimony, p. 3.
[150] Kollen direct testimony, pp. 62-63.
[151] Kollen direct testimony, pp. 63-64.

the Division 002 costs allocated to Division 091, together with the costs incurred directly by Division 091, to the Kentucky jurisdiction using this factor. [152]

However, only one of the three composite factor components is reasonable: gross direct property plant and equipment. The number of customers component is not reasonable because customer costs are incurred in a separate Call Center customer support division (012). The costs of Division 012 are appropriately allocated to Kentucky using a separate customer allocation factor. The total O&M component is not reasonable because it is not a comprehensive measure of all expenses managed by Division 002.[153]

In place of components for number of customers and total O&M expenses, a better and more comprehensive measure of expenses incurred at the Corporate Office Division would be total operating expense, which includes not only O&M, but also taxes, depreciation and amortization expenses. The total operating expense component is a reasonable proxy for the operating expenses included in the filing, and gross direct property plant and equipment serves as a reasonable proxy for ratebase and total operating expenses.

The Commission should modify the composite factor so that it is equally weighted between gross direct property plant and equipment, and total operating expenses. This will improve the composite factor so that it provides an allocation to Kentucky based on a comprehensive measure of the corporate office and Kentucky/Mid-States management and provision of services to Kentucky. This will have the effect of reducing the revenue requirement by $0.740 million.[154]

---

[152] *Id.* at 64.
[153] *Id.*
[154] *Id.* at 65-66.

E. __Research & Development Rider__

Beginning in Case No. 99-070, Atmos' predecessor Western Kentucky Gas received authorization to initiate a customer surcharge to collect costs on behalf of what was then-known as the Gas Research Institute, which later merged with another entity to form Gas Technology Institute ["GTI"].[155] As set forth in Western Kentucky Gas' responses to data requests in Case No. 99-070, unregulated interstate gas pipelines were passing the then-GRI charge on to LDCs such as Western Kentucky Gas;[156] GRI itself had three separate units that served customers in three natural gas industry segments: exploration and production, pipelines, and distribution and end-use;[157] according to Western Kentucky Gas, "the GRI R&D surcharge is, historically and currently, a component of gas cost from the interstate pipelines;" [158] in fact, the unregulated Texas Gas Transmission Co. supplied the schedule of surcharges Western Kentucky Gas used to initiate its initial R&D Rider.[159] By virtue of the operation of the R&D tracker, Western Kentucky Gas' retail customers were thus subsidizing the operations of unregulated businesses involved in gas exploration and production and pipelines.

Today, Atmos recovers $56,000 from customers through the R&D Rider, which it can, but is not required to, remit to GTI, which ostensibly conducts research for the benefit of the

[155] *See* http://www.gastechnology.org/About/Pages/History.aspx. As set forth in GTI's website, GTI's four-fold stated objectives are: "Expanding the supply of affordable natural gas and renewable energy; Ensuring a safe and reliable energy delivery infrastructure; Promoting the clean and efficient use of energy resources; and Reducing carbon emissions to the environment."
[156] Case No. 99-070, company response to PSC 2-53 a-c, p. 59/630 accessible at: https://psc.ky.gov/PSCSCF/1999%20cases/99-070Z/99-070z.pdf
[157] Case No. 99-070, company response to PSC 2-53 a-c, p. 59/630 accessible at: https://psc.ky.gov/PSCSCF/1999%20cases/99-070Z/99-070z.pdf
[158] Id., company's response to PSC data requests dated July 16, 1999, Item 52 c and d.
[159] Case No. 99-070, company's response to PSC data requests dated July 16, 1999, Item 52a, accessible at: https://psc.ky.gov/PSCSCF/1999%20cases/99-070V/99-070v.pdf

gas industry. In the instant case, Atmos seeks to increase funds collected under the R&D Rider by nearly 400% ($278,000). However, Atmos has failed to provide any documentation of how the GTI funding benefits its Kentucky customers. This funding is not required by GTI, or any other entity in the gas industry. Kentuckians should not be compelled to subsidize product development research, from which perhaps coincidentally, some Atmos unregulated affiliates may benefit.[160] The Company has failed to provide any quantification of direct benefits that the GTI brings to its customers, and has failed to provide any justification for the proposed increase in funding. As the GTI funding is entirely discretionary, the Attorney General therefore recommends that the Commission terminate the R&D Rider, or alternatively, reject Atmos' request to increase the rider's funding to GTI.

F. Residential Customer Charge

In Case No. 2018-00039, the Commission approved a settlement reached between Atmos and the Attorney General which provided for an interim reduction in base rates and in the PRP mechanism in the sum of $5.6 million, based on the impacts of the TCJA.[161] The Commission reduced the base rate component of the rate decrease in part by reducing the monthly residential customer charge from the existing $17.50 to $16.52.[162] The Attorney General urges the Commission that any additional reductions to Atmos revenue requirement made in the context of the instant case be conducted with either the same or a similar methodology that the Commission utilized in Case No. 2018-00039. In the event the Commission should award Atmos additional revenues, he urges the Commission to deny any

[160] Kollen direct testimony, pp. 75-76.
[161] Case No. 2018-00039, Order dated March 19, 2018.
[162] *Id.*, at p. 4.

additional increase to the residential customer charge, and instead pass any such increase through the Company's delivery charge.

III. CONCLUSION

WHEREFORE, the Attorney General respectfully requests that the Commission deny Atmos' proposed ARM mechanism, reduce Atmos' base rates by $16.937 million in accordance with the direct testimony of Attorney General witness Lane Kollen, set Atmos' return on equity at 8.8% in accordance with the testimony of Attorney General witness Richard A. Baudino, terminate Atmos' PRP program or alternatively place a cap on it in accordance with the provisions set forth in the instant brief, terminate the R&D Rider or alternatively deny the proposed increase in funding, deny Atmos recovery of any of its rate case expense, and grant all further relief as set forth in this brief, and in the direct testimony of his witnesses.

Respectfully submitted,

ANDY BESHEAR
ATTORNEY GENERAL

REBECCA W. GOODMAN
LAWRENCE W. COOK
JUSTIN M. McNEIL
KENT A. CHANDLER
ASSISTANT ATTORNEYS GENERAL
700 CAPITOL AVE., STE. 20
FRANKFORT KY 40601
(502) 696-5453
FAX: (502) 573-8315
Rebecca.Goodman@ky.gov
Larry.Cook@ky.gov
Justin.McNeil@ky.gov
Kent.Chandler@ky.gov

__Certificate of Service and Filing__

Counsel certifies that the foregoing is a true and accurate copy of the same document being filed in paper medium with the Commission within two business days; that the electronic filing has been transmitted to the Commission on April 23, 2018; that there are currently no parties that the Commission has excused from participation by electronic means in this proceeding.

This 23rd day of April, 2018.

Assistant Attorney General