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April 26, 2018

Gwen Pinson
Executive Director
Public Service Commission
211 Sower Blvd.
Frankfort, KY 40601

Re: Atmos Energy Corporation:
Case No. 2017-00349

Dear Ms. Pinson:

Atmos Energy Corporation, submits it Reply Brief.

I certify that the electronic filing is a complete and accurate copy of the original documents to be filed in this matter, which will be filed within two days of this submission and that there are currently no parties in this proceeding that the Commission has excused from participation by electronic means.

If you have any questions about this matter, please contact me.

Very truly yours,

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Attorneys for Atmos Energy Corporation

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

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

REPLY BRIEF OF ATMOS ENERGY CORPORATION

Atmos Energy ("Atmos Energy" or "Company") will address one issue in this reply to the Office of Attorney General's ("OAG") Post Hearing Brief. The Company's Pipeline Replacement Program ("PRP") is mischaracterized by the OAG. The OAG asserts that the PRP is excessively costly because Atmos Energy's growth rate is "nearly flat" and there have been virtually no savings associated with the program.[1] The OAG further incorrectly alleges that the PRP is specifically designed to minimize Commission oversight over the Company's PRP projects.[2] Both of these assertions are misleading and do not address the purpose of the PRP. The focus of the PRP is safety. The PRP is designed to replace obsolete pipe to maintain and improve the safety of the system for Atmos Energy's customers. Safety is not a growth-driven factor and is not relevant to the miles of pipeline replaced or the cost of replacement.

The primary purpose of the PRP is to provide a benefit to the customer by accelerating replacement of aging infrastructure that poses a possible safety and/or reliability concern in a manner that is more efficient than replacement and recovery through litigated rate case proceedings. Bare steel pipe is prone to failure over time. The number one cause of leaks on bare steel pipe is corrosion and once the corrosion process has started, corrosion will continue

[1] Attorney General's Post Hearing Brief at 17.
[2] *Id.* at 18.

until the pipe fails. Because of these concerns, the accelerated replacement of pipes made of bare steel materials is reasonable and prudent and such pipes and services should be replaced as expeditiously as possible to ensure the system remains safe.[3]

The underlying problem with the OAG's argument is that it fails to recognize that the fundamental purpose of infrastructure mechanisms like the Company's PRP is to enable utilities to accelerate replacement of aging infrastructure that poses potential safety and/or reliability concerns for customers. KRS 278.509 was enacted by the Kentucky legislature to enable utilities to accomplish these important objectives by allowing recovery of replacement investments outside of or between general rate cases. KRS 278.509 was clearly enacted to encourage these safety-related investment – not to discourage them. The Kentucky legislature, by enacting KRS 278.509, is in line with the vast majority of other states that provide rate mechanisms that foster accelerated pipe replacement.[4]

It is important to note that the OAG's complaint with the PRP is that the Company has spent too much money in a global sense replacing aging and obsolete infrastructure. The OAG has not criticized the appropriateness of any particular project or the actual costs incurred for any particular project. The OAG just complains the Company has spent too much, while failing to mention the concept of safety in its PRP recommendation. Under KRS 278.509, the test for whether the costs incurred in PRP projects are recoverable is whether the costs incurred are fair, just and reasonable. The OAG's one-sided analysis of the Company's PRP has provided no evidence of any kind that disputes the costs incurred by Atmos Energy in its PRP to date are not fair, just and reasonable and, therefore, properly recoverable.

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[3] *See* Atmos Energy's Response to the Attorney General's Initial Data Requests ("AG's First Request), Item 1.
[4] *See, e.g.*, Rebuttal Testimony of Mark A. Martin ("Martin Rebuttal") at 9 ("According to the American Gas Association, forty-one (41) states, including the District of Columbia, have specific rate mechanisms that foster accelerated pipe replacement").

Likewise, the OAG's assertion that the PRP should be judged relative to customer growth or cost savings is not compelling because the PRP is fundamentally a safety program. While there have been savings associated with the PRP as the OAG acknowledges, the key factor to judge its success is improvement in safety, which is best gauged by the reduction in leaks. The number of leaks has declined each year of the PRP from 1,127 in 2011 to 528 through August of 2017.[5]

Date	# Leaks
Jan, 2011	1,127
Jan, 2012	1,308
Jan, 2013	1,354
Jan, 2014	1,169
Jan, 2015	1,076
Jan, 2016	677
Jan, 2017	600
Aug, 2017	528

As the number of leaks is reduced, the potential harm to persons and property is necessarily reduced. The OAG's myopic view of the PRP overlooks its primary purpose of increasing the safety and reliability of the Company's system for its customers.

Another flaw in the OAG's analysis is his failure to consider the costs associated with pipe other than bare steel. Atmos Energy has consistently asserted that there are other types of pipe that need replacing due to safety issues such as early generation and un-locatable plastic pipe. These sections of pipe have been included in the estimates for 2023 forward. Indeed, the Commission has explicitly stated in its Order in Case No. 2014-00274 that "KRS 278.509 does not mandate that natural gas pipeline replacement programs be restricted to bare steel or

[5] Atmos Energy's Response to Commission Staff's Second Request for Information ("Staff's Second Request"), Item 18.

unprotected steel pipe, and specifically allows recovery of cost for investments in natural gas replacement programs which are not recovered in the existing rates of a regulated utility."[6]

When the costs of these additional facilities are considered, the PRP cost estimates remain within the parameters presented in previous annual filings. To the extent that the Company plans to request replacement of additional types of pipe in the time frame for which a PRP spending forecast is requested, the Company must forecast the cost of replacing non-bare steel materials that are not part of the remaining PRP bare steel estimated miles. Contrary to the OAG's assertions, the forecasted 2019-2025 spending cannot be reconciled to just the remaining bare steel miles. Because those years also include non-bare-steel replacements, current costs do not directly correlate. To do such a reconciliation would dramatically overstate the costs for replacement per mile of bare steel pipe, since the forecasted costs through 2025 contemplate replacing more than just bare steel pipe.[7]

The OAG fails to consider that the estimate of 2018 spending is based on budgeted costs of projects specifically approved for 2018. For the years 2019-2022, the Company's five-year plan was used, which identifies projects that should be undertaken in the future, but which are based on non-detailed projections of costs. For years 2023-2025, a generalized forecast of the need for system replacement is made together with broad projections of costs. As discussed by Mr. Smith at the hearing, detailed project estimates are only available for projects 12-18 months prior to construction.[8]

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[6] *Application of Atmos Energy Corporation to Establish PRP Rider Rates for the Twelve Month Period Beginning October 1, 2014*, Order at 4, Case No. 2014-00274 (Ky. PSC Oct. 10, 2014).
[7] Atmos Energy's Response to Commission Staff's Third Post Hearing Request for Information ("Staff's Third PH-DR"), Item 3.
[8] March 22, 2018, Video Transcript of Evidence at 1:17:30 – 1:18:40; *see also* Atmos Energy's Response to Staff's Third PH-DR, Item 3.

The OAG's criticisms of the PRP rely heavily on considered possible future investments for years extending out through 2025. A couple of points need to be made. First, as the Company has repeatedly said, except for projects 12 to 18 months out, there are no detailed cost projections – especially for the years beyond the Company's five year plan.[9] Secondly, the Commission, as it has in the past, will have the opportunity to scrutinize each year's proposed PRP projects and filings and evaluate whether the projects are warranted and whether the costs are fair, just and reasonable as contemplated by KRS 278.509.

Another error of the OAG's objection to the PRP is that Atmos Energy's plant in service is growing at an unjustified pace and that Atmos Energy over recovers capital costs of replacement due to lack of Commission oversight. The OAG's criticism of the PRP on the grounds it somehow limits the Commission's oversight is misplaced. The OAG claims:

> "…by next year, Atmos – a utility whose customer base has essentially flat-lined – will have succeeded in doubling its ratebase (currently at $430 million) since the PRP's inception, <u>all through</u> a between-rate cases incremental investment-tracking mechanism specifically designed to minimize Commission oversight."(emphasis added).[10]

There are several erroneous statements in the above quoted argument of the OAG. First, the OAG states that the Company's rate base will have doubled since the PRP's inception "…<u>all</u> through a between-rate cases incremental investment-tracking mechanism specifically designed to minimize Commission oversight."[11] The OAG's allegations that the Company's rate base has doubled "all through" PRP expenditures is simply incorrect. For example, for the forecasted test year in this case the Company has projected $34.0 million of Non-PRP capital expenditures.[12]

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[9] *See, e.g.*, Atmos Energy's Response to Staff's Third PH-DR, Item 3.
[10] Attorney General's Post Hearing Brief at 18.
[11] *Id.*
[12] *See* Atmos Energy's Response to Commission Staff's First Request for Information ("Staff's First Request"), Item 71, Plant Data Workpapers, KY Plant Data-2017 case, Capital Spending tab.

The pace of replacement is based on a defined project list, which is refined annually and projected into the budgeting process. Of course rate base will increase at an expanding rate, because old depreciated facilities are being replaced with new current cost facilities. Regardless of the miles of pipeline replaced, rate base is going to increase compared to the replaced and depreciated plant. The OAG's effort to associate the plant growth with excessive spending is obviously inappropriate. The only way rate base would not increase at an expanding rate would be if the Company failed to make required investments in its system. Also, the Company would note that while rate base has increased, on average the Company's bills have remained steady since 2007.[13]

Another flaw in this aspect of his argument is that the OAG fails to recognize that the Commission annually reviews in detail the projects and costs associated with each year's PRP proposal. The OAG's statement that the PRP was, and is, "…specifically designed to minimize Commission oversight"[14] is simply untrue. Each and every project under the PRP together with detailed information on project costs is presented annually to the Commission for review. The Commission reviews and scrutinizes each project and all expenditures under the PRP before issuing an order for the Company's PRP filing each year. The OAG has the right to intervene and participate in the proceeding. In fact, it is certainly reasonable to conclude that if anything, PRP expenditures are susceptible to more scrutiny in a stand-alone annual PRP filings than in a regular rate case where literally thousands of other pieces of financial information are presented for review by the Commission. The rate case review that the OAG suggests for PRP will necessarily limit the time and depth of analysis currently afforded to the Commission.

[13] *See, e.g.*, Atmos Energy's Response to Staff's Second Request, Item 3.
[14] Attorney General's Post Hearing Brief at 18.

If the PRP is eliminated, the primary effect will be to slow the pace of infrastructure replacement activity. The cost of replacement will not change. The type of facilities replaced will not change. The impact on rate base will not change. Only the timing of the events related to the PRP will change. Rate cases will necessarily become more frequent, complicated and expensive. OAG's concern for minimizing current rates over accelerating the public safety efforts of the Company is unjustified.

In conclusion, the Company urges the Commission to reject the OAG's recommendation that the PRP be terminated or alternatively, severely limited in scope. The PRP is a safety program that has worked well and will continue to do so. The Commission currently has and will continue to have oversight over the Company's PRP spending to assure that the costs being expended between rate cases are fair, just and reasonable.

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CERTIFICATION

I hereby certify that a true and accurate copy of the document to be filed in paper medium, that the electronic filing was transmitted to the Commission on April 26, 2018; that an original and One copy of the filing will be delivered to the Commission within two days; and that no party has been excused from participation by electronic means.

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