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April 17, 2018

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

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

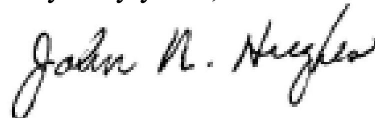
Dear Ms. Pinson:

Atmos Energy Corporation, submits its Post Hearing 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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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	)	

BRIEF OF ATMOS ENERGY CORPORATION

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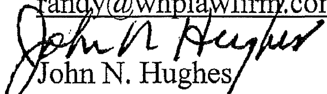

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CERTIFICATION

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 17, 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.

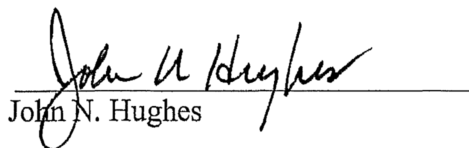

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TABLE OF CONTENTS

I. HISTORY OF THE CASE

II. SUMMARY OF KEY ISSUES

III. SUMMARY OF ATMOS ENERGY'S PROPOSED ADJUSTMENTS

IV. LEGAL OVERVIEW

V. CASE OVERVIEW

- A. Test Period
- B. Rate Base
  - 1. Introduction
  - 2. Summary of Rate Base

VI. REVENUE AND EXPENSES

- A. Introduction
- B. Background/Budgeting
  - 1. O&M Budget
  - 2. Capital Budget
  - 3. Budgeting Results
- C. O&M Expenses
  - 1. Kentucky Direct O&M (Division 009)
  - 2. Kentucky Midstates O&M (Division 091)
  - 3. Shared Services Expenses (Division 002)
  - 4. Employee Retirement Plan Expense
- D. Other Taxes
  - 1. Ad Valorem Tax Expense

E. Depreciation Expense

1. Net Salvage

F. Rate Base

1. Cash Working Capital

2. ADIT (NON-NOLC)

3. Non-PRP Capital Expenditures

4. Prepaids

G. Capital Structure

1. Senior Debt – Imputed Interest

H. Other

1. Rate Case Expenses

VII. PIPE REPLACEMENT PROGRAM RIDER

VIII. RATE OF RETURN

IX. ARM

X. ADIT-NOLC

XI. CLASS COST OF SERVICE

XII. R&D RIDER

XIII. CONCLUSION

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BRIEF OF ATMOS ENERGY CORPORATION

I. HISTORY OF THE CASE

On August 25, 2017, Atmos Energy Corporation ("Atmos Energy" or "Company") filed with the Kentucky Public Service Commission ("Commission") a notice of its intent to electronically file a general rate case ("Notice"). A copy of that notice was also served on the Kentucky Attorney General's Office of Rate Intervention ("OAG").

On September 28, 2017, Atmos Energy filed its application for an adjustment of rates and tariff modifications, effective October 28, 2017. By its letter dated October 3, 2017, the Commission notified Atmos Energy of certain filing deficiencies. On October 6, 2017, the Commission Staff notified Atmos Energy that its application met all minimum filing requirements.

On October 17, 2017, the Commission entered an Order, *inter alia*: (1) ordering that Atmos Energy's application be deemed filed as of October 5, 2017; (2) suspending Atmos Energy's proposed rates for six (6) months, up to and including May 3, 2018; and, (3) adopting a procedural schedule for this proceeding.

On October 19, 2017, the OAG filed its motion for full intervention, which was granted by the Commission's Order of October 24, 2017. The OAG is the only intervenor in this proceeding.

Following extensive discovery by and among the Company, OAG and Commission Staff,

a public hearing on Atmos Energy's application for an adjustment of rates and modification to tariffs was held on March 22, 2018. By agreement of the OAG and Atmos Energy, post hearing briefs were required to be filed with the Commission by April 17, 2018.

II. SUMMARY OF KEY ISSUES

1. Adjustment of Base Rates

   Atmos Energy proposes to adjust base rates to recover an additional $1,764,082 of annual revenue. This increase is approximately a 1.1% average annual increase in residential bills. Included in this adjustment is a change of the monthly customer charge of $0.39 and the monthly distribution charge of $0.0360 per Mcf.

2. Reduction of proposed rates to reflect the impact of the Tax Cuts and Jobs Act

   As a result of the Commission's investigation into the reduction of federal corporate income tax rate from 35% to 21%, Atmos Energy and the OAG entered into a settlement agreement filed on February 27, 2018 in Case No. 2018-00039. The settlement agreement provides for a reduction of approximately $5.6 million dollars in annual revenue from the originally proposed revenue requirement.

3. Annual Review Mechanism ("ARM")

   The Company's proposed ARM is designed to create a more efficient and lower cost process to review rates on an annual basis so that the rates paid by the customers more accurately reflect current costs. The Company is proposing the ARM to address the interests of customers, interveners and the Commission with a more efficient, cost-effective process, while at the same time better aligning the Company's costs and

revenues. Specifically, the ARM would provide assurance that the rates in place are appropriate and reflective of current cost of service. The ARM accomplishes this through annual, consistent and financially transparent rate reviews that ensure the Company earns no more than its authorized return while reducing the time and cost required in traditional ratemaking. The ARM provides for full discovery, review and investigation by the Commission, OAG, and other intervening parties without limiting or restricting the authority of the Commission.

4. Pipeline Replacement Program ("PRP")

The Company is replacing aging infrastructure to be proactive in modernizing its system. Providing safe and reliable gas service to all of its customers is Atmos Energy's most fundamental objective. The Company is acutely aware that its actions can directly impact the safety of its customers, communities and employees. In response to the OAG's assertion that this program be eliminated, or the annual spending be capped, the Company provided extensive data to justify the safety and system reliability benefits of the program and the need for continued spending at current or higher levels. Since beginning PRP in mid-2011, the Company has used the program to accelerate the replacement of mains and services. At the Company's current replacement rate, system-wide, the Company is on an approximate 80-year replacement cycle and would like to accelerate this replacement in order to maintain a safe and reliable system.[1] Since PRP's inception, the number of leaks on the Company's Kentucky system has been reduced by approximately half.[2] If the Company's ARM proposal is accepted, the Company would

[1] March 22, 2018, Video Transcript of Evidence at 1:45:40.
[2] Atmos Energy's Response to Commission Staff's Second Request for Information ("Staff's Second Request"), Item 18.

transition away from the PRP as a comprehensive annual review mechanism would make the PRP redundant.

5. Return on Equity ("ROE")

The Company, through its expert witness, initially proposed an ROE of 10.3% and the 10.3% is what is reflected in the Company's proposed revenue requirement. That recommendation was later updated by the Company's expert witness to 10.6% based on the most current financial information available. The OAG's witness, in response to Vice Chairman Cicero's comment that if anything right now there was pressure for the ROE rate to go up, conceded that the rising interest rate environment leads to upward pressure on ROE rates.[3] The OAG's witness ignored these market forces and continued to recommend 8.8%, which even he admits no Commission has recently adopted, including the Commission.

6. Update of R&D Rider

Atmos Energy proposes to update its R&D rider. This tariff has not been revised since its initial approval in 1999. With the current R&D unit charge of $0.0035 per Mcf and assuming sixteen (16) Bcf of annual sales, applicable customers contribute approximately $56,000 for R&D efforts. Increasing the R&D unit charge to $0.0174 per Mcf would increase funding by approximately $222,000 for a total annual contribution of approximately $278,000. The Company's proposed increase would increase the average residential bill by approximately $0.07 per month. Also, the Company's proposed annual contribution of approximately $278,000 would still be lower than the annual contribution

[3] March 22, 2018, Video Transcript of Evidence at 4:08:59.

that Columbia Gas of Kentucky, a similarly-sized utility, makes for research and development initiatives.

7. Cash Working Capital

In accordance with the terms of the settlement reached in the Company's prior 2015 rate case, a lead/lag study was performed by the Company. However, the amount of cash working capital included in rate base in this proceeding by the Company was calculated under the one-eighth of O&M expense method which the Commission has approved in all Atmos Energy rate cases since it purchased Western Kentucky Gas in 1987. The Company supports continued use of this longstanding and objective method and refutes the erroneous calculations in the OAG's lead/lag study.

8. ADIT/NOLC

This issue was fully-resolved by the issuance of IRS Public Letter Ruling (PLR), Number 201534001 ("Atmos Energy PLR"). The Atmos Energy PLR is directly applicable to the Company's specific tax situation in Kentucky. Nevertheless, the OAG continues to re-litigate this issue and its witness even introduced a new proposal on the stand in an attempt to collaterally attack the Atmos Energy PLR. The OAG's proposals are contradictory to the Atmos Energy PLR. The Commission's rejection of the filed position of the Company on this issue, which complies with the specific guidance of the Atmos Energy PLR and applicable IRS regulations, will result in the Company committing a tax normalization violation, and thus, will ultimately hurt Kentucky ratepayers through higher rates. To the extent the Commission is looking for a definitive ruling on this issue, there is no greater authority than the Atmos Energy PLR – it is the specific answer of the IRS on this matter and the IRS will not provide further interpretation of a PLR.

9. Net Salvage

The OAG has proposed a radical change to how net salvage is determined for rate making purposes. The OAG's witness proposing this change was unable to provide any regulatory or authoritative texts that supported his recommended approach. Indeed, the OAG's proposal violates traditional depreciation theory, this Commission's precedent, intergenerational equity and FERC's guidance on accrual accounting. The OAG witness' proposal was made without providing a depreciation study and the same OAG witness did not propose any adjustment to the depreciation study that the Company provided in Case No. 2015-00343.

III. SUMMARY OF ATMOS ENERGY'S PROPOSED ADJUSTMENTS AND OTHER RELIEF

(1) Atmos Energy originally sought Commission approval of an increase in annual revenue of $10,416,204. Subsequently, the Company acknowledged a downward adjustment of $53,216 as reflected in Atmos Energy's Response to Staff's Second Request, Item 37. Additionally, as a result of the Commission's INVESTIGATION OF THE IMPACT OF THE TAX CUTS AND JOBS ACT ("TCJA"), the Company and the OAG agreed to a revenue reduction of approximately $5.6 million dollars, which the Commission approved on March 19, 2018.[4] In Exhibit GKW-R-1 in this case, the Company also incorporated the calculation of amortizing accumulated deferred tax items.

As a result of these adjustments, the Company's revised revenue requirement is $1,764,082 as shown in Exhibit GKW-R-1 of Company witness Greg Waller's rebuttal testimony. This results in an average monthly increase in residential bills of $0.58, representing

[4] *Electronic Investigation of the Impact of the Tax Cuts and Jobs Act on the Rates of Atmos Energy Corporation*, Order, Case No. 2018-00039 (Ky. PSC Mar. 19, 2018).

a 1.1% increase.[5] Included in the increased monthly bill is a proposed increase in the monthly customer charge from $17.50 to $19.45 to reflect the $0.39 increase and rolling in the current (at the time of the filing) PRP charge of $1.56/month into base rates.[6]

If approved, the new rates will increase revenues sufficiently to provide an overall rate of return on rate base of 7.72% on the adjusted test year rate base of $427,151,221.[7] The actual increases by amount and percentage for each customer class are listed in the schedule attached to Staff's Post Hearing Data Request, Item 1.

(2) Atmos Energy's application further requests the following:

(a) Implementation of an annual review mechanism ("ARM") to allow for the annual review and adjustment of cost of service and rates.

(b) Update the time period to weather normalized revenues under the Company's weather normalization adjustment ("WNA") rider.

(c) Update the Company's Research and Development Rider ("R&D") unit charge.

The relief requested in this proceeding is designed to maintain the general balance of fixed and variable elements in the distribution rates, reflect the underlying costs, characteristics of service, mitigate depletion of revenue caused by increased operating costs and capital investments in Kentucky.

IV. LEGAL OVERVIEW

Under Kentucky law, the Company is entitled to receive "fair, just and reasonable rates"

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[5] Atmos Energy's Response to Commission Staff's Post Hearing Request for Information to Atmos Energy Corporation ("Staff's PH-DR") , Item 1.

[6] *Id*.

[7] Rebuttal Testimony of Greg Waller ("Waller Rebuttal"), Exhibit GKW-R-1, Schedule A.

for the services it provides.[8] There is no single prescribed method for establishing rates.[9] A utility's rates must, however, provide enough revenue to cover its operating expenses and the cost of capital.[10] As our own Kentucky high court has stated, when establishing rates, the Commission must ensure the resulting rates will, *inter alia*, "…enable the utility to operate successfully, to maintain its financial integrity [and] to attract capital."[11]

In Kentucky, utilities have the option to file their rate cases using either:

(1) A twelve (12) month historic test period that may include adjustments for known and measurable changes; or

(2) A fully forecasted test period presented in the form of pro forma adjustments to the base period.[12]

In this case, as it has in its previous five (5) rate cases in Kentucky, Atmos Energy elected to proceed with a fully forecasted test period because it believes this method presents a more accurate portrayal of the Company's revenue requirement.

Under KRS 278.190(3), "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 . . . **."** The utility must show by substantial evidence the reasonableness of its test-period expenses and any proposed adjustments to those expenses, as well as the methodology used to determine its revenue requirement.[13] Approved rates must "enable the utility to operate successfully, to maintain its financial integrity, to attract capital and to compensate its investors for the risks assumed".[14]

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[8] KRS 278.030(1).
[9] *Kentucky Industrial Utility Customers, Inc. v. Kentucky Utilities Co.*, 983 S.W.2d 493 (Ky. 1998).
[10] *Federal Power Comm'n v. Hope Natural Gas Co*., 320 U.S. 591 (1944).
[11] *Commonwealth ex rel Stephens v. South Central Bell Telephone Co.*, 545 S.W.2d 927, 930-31 (Ky. 1976).
[12] 807 KAR 5:001(16)(1)(a).
[13] *Alternative Rate Filing of Coolbrook Utilities, LLC*, Order, Case No. 2011-00433 (Ky. PSC May 9, 2012).
[14] *National Southwire Aluminum Co. v. Big Rivers Electric Corp.*, 785 S.W.2d 503, 512-513 (Ky. 1976).

Atmos Energy has provided detailed financial information which fully supports its request for rate relief in this proceeding. The written testimony, exhibits, data responses and hearing testimony more than meet the substantial evidence standard. As such, the Company believes the evidence is sufficiently probative to compel findings consistent with the Company's request.[15]

In contrast to the evidence provided by Atmos Energy, the OAG has failed to provide credible evidence on the issues it has raised in this case. Its testimony consists solely of opinions of two witnesses, with little legal or factual support. As this Commission has held, when opinions are unsupported by any "factual evidence" they must be rejected.[16] It is the Commission that must determine the credibility of the witnesses and the weight to be given to their testimony.[17] The weight of evidence is gauged by the credibility of the witnesses.[18] "The administrative trier of fact has the exclusive province to pass on the credibility of the witnesses and the weight of evidence."[19] When closely analyzed and with very limited exceptions, the unsupported opinions of the OAG's witnesses as explained throughout this Brief, are insufficient to overcome the detailed factual and financial information provided by the Company.

V. CASE OVERVIEW

A. Test Period

Atmos Energy's fully forecasted test period is the twelve month period commencing April 1, 2018 and ending March 31, 2019. The base period is the twelve month period beginning

[15] *Lee v. International Harvester Co.*, 373 S.W.2d 418 (Ky. 1963).
[16] Administrative Case No. 273, Order at 8, (Ky. PSC July 5, 1984).
[17] *Energy Regulatory Com. v. Kentucky Power Company*, 605 S.W.2d 46, 50 (Ky. App. 1980).
[18] An Adjustment of Rates of Union Light and Power Company and Abandonment of Facilities, Order, Case Nos. 8419 and 8373 (Ky. PSC May 25, 1982).
[19] *Energy Regulatory Com.*, 605 S.W.2d at 50.

January 1, 2017 and ending December 31, 2017.[20]

B. Rate Base

1. Introduction Atmos Energy has calculated its adjusted test year rate base to be $427,151,221.[21] This was calculated by utilizing a thirteen month average for each component of rate base, with the limited exceptions discussed below. The OAG has proposed various adjustments to rate base. Each of those proposed adjustments is also addressed below.

2. Summary of Rate Base

As shown on Schedule B.1F to Exhibit GKW-R-1, Atmos Energy's thirteen month average jurisdictional rate base as of March 31, 2019, is as follows:

RATE BASE COMPONENTS	FORECASTED TEST PERIOD 13 MONTH AVERAGE
Plant In Service	$ 657,447,129
Construction Work In Progress	$ 27,493,203
Accumulated Depreciation and Amortization	($ 191,846,139)
Property Plant and Equipment, Net	$493,094,193
Cash Working Capital Allowance	$ 3,270,504
Other Working Capital Allowances (Inventory & prepaids)	$ 8,469,206
Customer Advances For Construction	($ 1,437,537)
Regulatory Assets/Liabilities	($ 34,338,567)
Deferred Income Taxes & Investment Tax Credits	($ 41,906,579)
Rate Base	$427,151,221

VI. REVENUE AND EXPENSES

A. Introduction

For its base period, Atmos Energy filed total operating revenues of $156,713,247 and total operating expenses of $124,541,937, for a total net operating income of $32,171,310.[22]

[20] Direct Testimony of Greg Waller ("Waller Direct") at 4.
[21] Waller Rebuttal, Exhibit GKW-R-1, Schedule A.
[22] Waller Rebuttal, Exhibit GKW-R-1, Schedule C.1.

Atmos Energy has proposed various adjustments to revenues and expenses for the forecasted test period, resulting in projected revenues and expenses of $173,964,591 and $140,998,517 respectively for a net operating income of $32,976,074.[23] The OAG has proposed various adjustments to rate base and to operating and maintenance ("O&M") expenses. Each of those proposed adjustments is addressed below.

B. Background/Budgeting

1. O&M Budget

O&M costs for Atmos Energy are budgeted on a fiscal year basis which begins October 1 of each year.[24] The budgeting process formally begins in late May and culminates with completion of final budgets in late August for the following fiscal year.[25] Budget preparation is based on determining the upcoming annual system requirements necessary for the continued safe and reliable operation of the Company's system, as well as any additional investment required to support system growth.[26]

The Company's budgeting process involves numerous levels of input, review and approval. The process begins at the supervisor/managers level and extends through the division leadership.[27] Once approved at the division level, senior management acting through the Company's Management Committee, reviews and modifies the budget as needed.[28] When ultimately approved, the budget is sent to the Board of Directors for final approval.[29] The Company has provided detailed information concerning its O&M budgeting process, including budget instructions, assumptions, policies, procedures and timelines.[30]

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[23] *Id.*
[24] Waller Direct at 21.
[25] *Id.*
[26] Atmos Energy's response to Commission Staff's First Request for Information ("Staff's First Request"), Item 9.
[27] Waller Direct at 21.
[28] *Id.*
[29] *Id.*
[30] Atmos Energy's response to Staff's First Request, Item 9.

The Company has also provided monthly budget variance reports for O&M expenses from July 2016 through February 28, 2018.[31] These reports prove that the Company's O&M budgeting process produces accurate and reliable O&M budgets.

2. Capital Budget.

The Company plans its capital expenditures ("CapEx") over five fiscal years, with a focused emphasis on the first year (the upcoming year) of that five (5) year period.[32] The first year capital budget is project-specific and is extremely detailed.[33] The process is initiated during the Company's third fiscal quarter by a request from the Finance Department for a "bottom up" submission of projects from operations supervisors and managers in Kentucky.[34] All proposed projects, vehicles and equipment must be identified by need and cost. Budgets are then prepared based on meeting the following five (5) objectives:

(1) Formalize the process of identifying construction needs and projecting capital expenditures;
(2) Assess the economic feasibility of individual construction projects;
(3) Determine overall capital requirements for the planning periods;
(4) Reassess long term maintenance requirements annually; and
(5) Review post construction projects and work practices and apply procedural improvements as appropriate.[35]

The process is normally finalized by late August. During the review period, the projects are reviewed and substantiated in detail.[36] The final proposed budget is then reviewed by the Division's senior management, the corporate executive operations management and the Company's Management Committee composed of senior executives. The CapEx budget for Kentucky, along with the Company's total CapEx Budget, are presented to the Board of

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[31] MFR 16(7)(o) and subsequent supplemental filings.
[32] Atmos Energy's response to Staff's First Request, Item 11.
[33] March 22, 2018, Video Transcript of Evidence at 2:11.
[34] Atmos Energy's response to Staff's First Request, Item 11.
[35] *Id.*
[36] *Id.*

Directors for approval.[37] All approved projects are transferred into the Company's capital tracking system (POWERPLANT) and are ready for appropriation.[38]

The Company's priorities for capital expenditure are as follows, in descending order of importance:

(1st) Public safety;
(2nd) System capacity and reliability;
(3rd) Public work;
(4th) Customer growth;
(5th) Fleet/equipment; and
(6th) Support of long term technological program.[39]

3. Budgeting Results.

Atmos Energy believes that both its O&M and its capital budgeting processes are validated when budgeted costs are compared to actuals.

For O&M, the following table compares actual O&M expenses to budget over a five (5) year period:[40]

Fiscal Year	Actual $	Budget $	Over/Under $	Variance
2016	$27,496	$26,191	$1,305	5.0%
2015	$27,922	$26,762	$1,160	4.3%
2014	$26,515	$26,804	$(289)	(1.1%)
2013	$25,509	$24,913	$596	2.4%
2012	$23,540	$22,362	$1,178	5.3%

[37] *Id.*
[38] *Id.*
[39] *Id.*
[40] Waller Direct at 25.

Dollars in thousands

For capital expenditures, the following compares budget to actuals over the most recent three (3) year period.[41]

Fiscal Year	Actual Expense	Budget Expense	Over/Under	Variance
2017	$72,891,836	$71,709,721	$1,182,116	1.6%
2016	64,190,439	64,026,131	164,307	.26%
2015	55,486,654	55,853,703	(367,049)	(.66)%

The importance of a utility's budgeting process in a forecasted test period case has been recognized by the Commission:

> "When a forward-looking test period approach is used, the Commission's focus is on determining the reasonableness of the utility's budgeting and other processes used to arrive at the forward-looking test period balances. One of the methods used to determine the reasonableness of the budgeting process is a review of the utility's budget versus actual results variance analysis."[42]

Atmos Energy has a proven history of accurately projecting future O&M and capital expenses and respectfully requests the Commission to recognize this when analyzing the Company's test year projections. Contrary to the OAG's assertion that forecasted inflation rates should be used to project future capital expenditures, the consistency of budget to actual investments confirms the Company's position that investment is need-based, not inflation based.[43]

C. <u>O&M EXPENSES</u>

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[41] Atmos Energy's response to Staff's Second Request, Item 16, Attachment 1.

[42] *An Adjustment of the Gas Rates of the Union Light, Heat and Power Company*, Order at 4-5, Case No. 2005-00042 (Ky. PSC Dec. 22, 2005).

[43] Waller Rebuttal at 4.

1. Kentucky Direct O&M (Division 009)

(i) OAG Proposed Adjustments to Kentucky Direct O&M Expense

OAG Witness Mr. Lane Kollen proposes two adjustments to the Company's test year projected O&M Expense for Kentucky Direct O&M Expense.

(a) Disallow the Company's proposed test year increase for vehicles and equipment expense of $0.195 Million; and

(b) Disallow the Company's proposed test year increase for outside services expense of $0.368 Million.[44]

The quantitative effect of these two adjustments on the Company's revenue requirement is a reduction of $566,638.[45] Before addressing the specifics of these two adjustments, it is important to note that Mr. Kollen compares projected test period expense – not to the base period expense as required by applicable Kentucky law – but to 2016 actuals.[46]

KRS 278.192 provides as follows:

> "For the purpose of justifying the reasonableness of a proposed general increase in rates, the commission shall allow a utility to utilize either an historical test period of twelve (12) consecutive calendar months, or a forward looking test period corresponding to the first twelve (12) consecutive calendar months the proposed increase would be in effect after the maximum suspension provided in KRS 278.190(2).
>
> > (a) Any application utilizing a forward looking test period shall include a base period to be filed with the application, which begins not more than nine (9) months prior to the date of filing, consisting of not less than six (6) months of actual historical data and not more than six (6) months of estimated data at the time of filing."

807 KAR 5:001(16)(6)(a) further provides:

> "All applications requesting a general adjustment in rates supported by a fully forecasted test period shall comply with the requirements established in this subsection. (a) The financial data for the forecasted period shall be presented in the form of pro forma adjustments to the base period."

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[44] Direct Testimony of Lane Kollen ("Kollen Direct") at 39-40.
[45] *Id.* at 5.
[46] *Id.* at 39-40.

Mr. Kollen's proposed adjustments totally ignore the base period expenses. The period from the end of calendar year 2016 to the end of the test period covers 27 months. This is inconsistent with the provisions of KRS 278.192 and 807 KAR 5:001(16)(6)(a) and should be rejected. When compared to base year expense levels, the increase for vehicles and equipment is $83,245 and for outside services it is an increase of $214,317.[47]

Mr. Kollen does not dispute the reasonableness of the expenses. Likewise, Mr. Kollen does not raise any concerns or issues with the Company's budgeting process. He simply compares them to expenses from an inappropriate time period. It should also be noted that Mr. Kollen's O&M analysis conveniently fails to mention budget categories where the Company's test year O&M expenses were less than calendar year 2016.[48]

When asked whether he had reviewed the Company's "rationale" for the increases in these two categories of expense, Mr. Kollen testified as follows:

> **Q. Have you reviewed the Company's rationale for the increases in these expenses?**
> A. Yes. The Company states that the "primary driver" for the increase in vehicles and equipment expense is "the replacement of leased vehicles." The Company provided no further support for this increase in forecast expense. The Company provided no rationale for the increase in outside services expense other than to explain that the expense in 2016 included $0.847 million in settlement expense.[49]

Mr. Kollen's response is typical of much of his testimony – conclusory statements unsupported by facts in the record. For example, in the OAG's first set of data requests, the Company was requested to provide a variance analysis for each category of expense comparing test year to calendar year 2016 actual expenses and to identify the reasons for the changes.[50] The Company complied and provided the requested information. Under the "Explanation" column,

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[47] Atmos Energy's response to the Attorney General's Initial Data Requests ("AG's First Request"), Item 22, Attachment 2, Part B and Part C.
[48] *See Id.*
[49] Kollen Direct at 40.
[50] *See* Atmos Energy's response to AG's First Request, Item 22.

the Company did, in fact, explain that the primary driver for the increase in vehicle and equipment expense is the "replacement of leased vehicles in accordance with our company vehicle replacement guidelines."[51]

The OAG had no follow up questions concerning this issue in its second round of discovery. No information was requested concerning the number of vehicles replaced, the costs for replacements, etc. In fact the OAG did not even ask for a copy of the Company's guidelines for vehicle replacements. Without any additional follow-up, Mr. Kollen simply concluded the increase was unreasonable when compared to prior expense levels from 2016.

Mr. Kollen's next statement in the quotation above is even more telling. Mr. Kollen testified that as to the increase in outside services, the Company provided "no rationale" for the increase.[52] This is simply false as evidenced by the Company's response to the Attorney General's First Request, Item 22. The Company did, in fact, provide the "rationale" for the projected increase in outside services. The Company explained that the increase was "… related to well logging expense associated with utility owned storage fields in Kentucky that is set to occur in FY18."[53]

As noted above, Mr. Kollen's proposed adjustment to Ky-Direct O&M is a reduction of $566,638, which represents the total combined difference between the Company's projected test year expenses for these two cost categories and 2016 actuals. The combined total increase in these two cost categories when compared to test year from base period (rather than 2016 actuals) is $297,562.[54] Mr. Kollen accordingly is proposing to deny the Company <u>any</u> increase in these two cost categories while simultaneously ignoring the multiple cost categories that decreased over the same period. Mr. Kollen's use of 2016 actuals not only denies the Company its

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[51] Atmos Energy's response to AG's First Request, Item 22, Attachment 2 Part B.
[52] Kollen Direct at 40.
[53] Atmos Energy's response to AG's First Request, Item 22, Attachment 2, Part C.
[54] *Id.*

requested increase of $297,562 from base period to test period, but also the increase of $265,113 from 2016 actuals to base year. An error compounded by error.

2. Kentucky/Midstates O&M (Division 091)

(i) OAG's Proposed Adjustments to Kentucky/Midstates O&M Allocated to Kentucky

Mr. Kollen makes three adjustments to the Company's test year projected O&M Expense incurred at the Kentucky/Midstates Division and allocated to Kentucky.

(a) Disallow telecom expense increase of $.104M (after 50.25% allocation);
(b) Disallow travel and entertainment expense increase of $.080M (after 50.25% allocation); and
(c) Disallow outside services increase of $.648M (after 50.25% allocation).[55]

As he did with his proposed adjustment to the Kentucky Direct O&M expense, Mr. Kollen has compared test year projected expenses to 2016 actuals, as opposed to base year as provided for in 807 KAR 5:001(16)(b)(a). The quantitative effect of Mr. Kollen's three adjustments based on 2016 actuals is a decrease to the Company's revenue requirements of $837,684.[56]

For the same reasons set forth above regarding Mr. Kollen's proposed adjustments to Kentucky Direct O&M, his proposed adjustments to Kentucky/Midstates projected O & M expenses should be denied. Namely, Mr. Kollen simply ignores the base period entirely and adjusts expenses for telecom, travel and entertainment and outside services to the calendar year 2016 levels while simultaneously ignoring the multiple cost categories that decreased over the same time period. The Company's O&M expenses are based on its most recent budget which is consistent with the methodologies the Company has traditionally used in forward looking filings

[55] Kollen Direct at 41-42.
[56] *Id.* at 5.

in Kentucky and consistent with the operating expenses approved by the Commission in Case No. 2013-00148. The budget is prepared consistent with the process described above and in Mr. Waller's direct testimony, and the Company has proven over the years that its O&M actuals align closely with budgeted amounts. As with Kentucky Direct O&M, the OAG asked no follow up questions relating to the above three categories of expense in its second round of discovery; did not object to the reasonableness of the base period amounts; and did not challenge the accuracy of the underlying numbers or the Company's budgeting process.

3. Shared Services Expenses (Division 002)

(i) Directors' Expense

Mr. Kollen originally proposed an adjustment to remove Director's Stock Expense in the sum of $347,235.[57] Mr. Kollen erroneously applied his adjustment to the entire budget category, rather than the specific subaccount as the Company noted in its response.[58] In Atmos Energy's response to Staff's Post Hearing Request, Item 7, the Company notes that the gross amount of Director's Stock Expense is $3,493,913 that, when allocated at 5.20%, is $181,683.

The sole basis for Mr. Kollen's recommended adjustment is that it constitutes incentive compensation. Mr. Kollen acknowledges that it is appropriate for the Company to compensate its Directors for their service and recover that just and reasonable expense for rate making purposes.[59] Accordingly, the central issue is whether this director's stock expense constitutes incentive compensation, not whether this is an unwarranted or unreasonable cost of doing business.

To clarify the record on this subject, the Company notes that there are two types of Directors' compensation that are appropriately included in the revenue requirement of this case.

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[57] *Id.*
[58] Atmos Energy's response to AG's First Request, Item 33.
[59] Attorney General's response to Atmos Energy's Requests for Information (Atmos Energy's First Request), Item 17; *see also* Waller Rebuttal at 9.

Neither type of compensation constitutes "incentive compensation" as Mr. Kollen alleges. The first type of compensation represents a retainer fee. Directors can either take the cash or convert it to stock.[60] As Company witness Waller pointed out in his rebuttal testimony, this type is defined and set in terms of dollars and the fact that Directors are given the option to convert their retainer fee to Company stock does not make it incentive compensation.[61] As Mr. Waller noted only a couple of the Directors take this option – most take the cash option.[62]

The second type of compensation represents a retirement benefit and is the "stock expense" as calculated above ($181,683 allocable to Kentucky). It is defined in shares of stock but represents a "retirement benefit." It is charged to expense every year but Directors cannot sell it until they retire and therefore it is appropriately classified as a retirement benefit and not incentive compensation. There is nothing in the record or in Mr. Kollen's testimony to substantiate his allegation that either type of compensation constitutes incentive compensation.

4. Employee Retirement Plan Expense

Mr. Kollen has recommended a $579,127 reduction to the Company's revenue requirement based on his recommendation to reduce Company employee retirement expense.[63] The source of this adjustment is the Commission's decisions in recent rate proceedings to disallow recovery of both defined benefit plan contributions and defined contribution plan (401(k) plans) contributions for those employees who participate in both plans.[64] Although the Company recognizes the Commission's recent orders referred to by Mr. Kollen, the Company does not believe they should be controlling in this case.

The Company transitioned from its Defined Benefit Plan in 2010. At that time, those

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[60] March 22, 2018, Video Transcript of Evidence at 2:05.
[61] Waller Rebuttal at 9.
[62] March 22, 2018, Video Transcript of Evidence at 2:03.
[63] Kollen Direct at 5.
[64] *Id.* at 45-46.

employees participating in the Defined Benefit Plan had the option of staying in the Defined Benefit Plan or switching to the Defined Contribution Plan.[65] There are 145 employees in Kentucky who participate in both.[66] The amount of 401(k) matching contributions included in the test year for those employees who also participate in the Defined Benefit Plan is approximately $579,127.[67]

The Company's Defined Benefit Plan was not designed to provide for all of an employee's retirement needs, unlike many other types of pension plans.[68] It was designed to merely be one component of an employee's overall retirement needs.[69] Indeed, the Company's retirement plan expenses are part of the Company's total compensation package provided to employees.[70] The compensation package is part of the Company's Total Rewards strategy.[71] The Total Rewards program was developed in 1998 and has been subject to appropriate changes or revisions to allow the Company to remain competitive within the marketplace.[72] Taken as a whole, the Total Rewards package is targeted at the 50th percentile (median) of pay and benefit at peer companies that are similar in size and/or industry to Atmos Energy.[73] The Company's goal is to ensure that Atmos Energy is able to compete in the marketplace to attract and retain the caliber of employees necessary to operate a safe and reliable gas utility system.[74]

In its Order in the KU case, quoted by Mr. Kollen on p. 45, lines 16-21 in his Direct Testimony, the Commission referred to KU's defined benefits plan as providing "generous retirement plan benefits"; and, when added to the 401(k) matching contributions, the

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[65] March 22, 2018, Video Transcript of Evidence at 2:41 and 2:42.
[66] *Id.* at 2:42.
[67] Atmos Energy's Response to Staff's Second Request, Item 24(e), Attachment 1; *see also* Kollen Direct at 46.
[68] March 22, 2018, Video Transcript of Evidence at 2:43.
[69] *Id.* at 2:44.
[70] Waller Rebuttal at 10.
[71] *Id.*
[72] *Id.*
[73] *Id.*
[74] *Id.*

Commission determined the amounts were excessive. Based on Mr. Waller's description of the Company's Defined Benefit Plan as not providing generous benefits, the Commission's rationale in KU should not apply to this situation.

The OAG has made no comparison of the defined benefit plans that were the subject of the two relied upon recent PSC decisions to the Company's defined benefit plan.[75] Without a comparison of the plans, there can be no basis for determining that contributions to the Company's plan are "excessive."

The Company respectfully urges the Commission to view each utility's retirement benefits on a case by case and not assume that all defined benefit plans are equal. In some cases, as here, where the defined benefit plan does not provide "generous" retirement plan benefits, a matching 401(k) contribution for employees participating in both, should not be deemed excessive.

D. OTHER TAXES

1. Ad Valorem Tax Expense

The Company's test year forecast for ad valorem tax expense is $5,076,000.[76] This was calculated using 2017 estimated ad valorem tax expense of $4,697,636 plus 8% to arrive at the 2018 estimated tax expense. Per the required base period update, the Company has accrued $4,884,792 of direct ad valorem tax expense for the year ending December 31, 2017 (the base period in this case).[77] The Company's forecasted ad valorem expense for the test year is accordingly only 3.9% more than the amount actually accrued during calendar year 2017.[78] This 3.9% increase is extremely conservative given the Company's property, plant and equipment are

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[75] *Id.*
[76] *Id.* at 12.
[77] *Id.*
[78] *Id.*

expected to grow by 13% over the same time period.[79]

There are two elements in determining the amount of ad valorem tax. (1) The assessed value and (2) the tax rate. Here the Company's net plant has and will continue to increase. The tax rate is not expected to go down within the forecasted test year. Accordingly, with the Company's rate base clearly rising and the tax rate remaining flat, a significantly higher future ad valorem tax expense should be considered a mathematical certainty. Mr. Kollen's adjustment is based upon 2016 and 2017 accruals of estimated taxes, which is not the same as the taxes incurred or paid for those time periods. As Mr. Waller testified, the latest actual finalized tax payment was for calendar year 2015.

Mr. Kollen has recommended a reduction in forecast ad valorem tax expense of $0.539 million and a corresponding reduction in the Company's revenue requirement of $543,158.[80] Based on Mr. Kollen's stated reasons for the adjustment, it appears he has misunderstood the facts.

Mr. Kollen testified as follows:

> **Q. Is this forecast ad valorem tax expense reasonable?**
>
> A. No. It is excessive and unjustified. The Company's actual ad valorem expense has declined over the most recent fiscal years while its plant balances have continued to increase. The Company **actually incurred** ad valorem expense of $5.721 million in fiscal year 2015, $5.127 million in fiscal year 2016, and $4.534 million in fiscal year 2017, including allocations from the Kentucky/Midstates and the SSU Divisions for ratemaking purposes. The Company's net plant balances were $459.421 million at December 31, 2014, $506.208 million at December 31, 2015, $553.636 million at December 31, 2016, and $604.160 million at September 30, 2017, including allocations from the Kentucky/Midstates and SSU Divisions for ratemaking purposes.[81] (Emphasis added)

Mr. Kollen's proposed adjustment is based on an erroneous belief that the final amount of

[79] *Id.*
[80] Kollen Direct at 52; *see also* Kollen Direct at 5.
[81] Kollen Direct at 50-51.

ad valorem taxes paid or due (or to use Mr. Kollen's words – "actually incurred") for FY 2016 was $5.127 million and, for FY 2017 was $4.534 million. Mr. Kollen, therefore, concludes that even though the Company's net plant balances went up by several million dollars each year, the ad valorem tax the Company "paid" went down each year. These amounts, however, are the expense accruals recorded on Atmos Energy's books – they are not the final cash amounts paid or due.[82]

What Mr. Kollen fails to understand is that 2015 is the only year he references that the Company has resolved with the Kentucky Department of Revenue as to the value of the Company's plant and equipment in Kentucky and the final amount of tax due. The amount of ad valorem taxes for 2016 and 2017 have not been finalized and the dollar amounts cited by Mr. Kollen only represent the amount the Company has accrued so far on its books for ad valorem taxes for those two years.[83]

The Company is in negotiations currently with the Commonwealth of Kentucky for Tax Year 2016. The initial valuation and initial invoice for 2016 was paid under protest. The Company paid taxes based on its claimed value and will receive additional invoices for any difference between the claimed taxes and the settled taxes once the value has been settled. The Company has not yet received even the initial valuation and tax due notification for 2017.[84]

E. DEPRECIATION EXPENSE

1. Net Salvage

Mr. Kollen has proposed a reduction to the Company's depreciation expense to reflect his novel approach in determining net salvage for ratemaking purposes. The quantitative effect of

[82] March 22, 2018, Video Transcript of Evidence at 1:57.
[83] Atmos Energy's response to AG's First Request, Item 24.
[84] *Id.*; *see also* Atmos Energy's response to Attorney General's Supplemental Data Requests ("AG's Second Request"), Item 6.

his proposed adjustment is to reduce the Company's revenue requirement by $3,531,704.[85]

Mr. Kollen testified that he sees three approaches to reflect net salvage in depreciation rates. The "first approach" is to include future estimated removal costs in net salvage rates. The "second approach" is to include no estimate of future net salvage in depreciation rates. The "third approach" is to include net salvage at a level based on recent net salvage.[86]

Mr. Kollen's proposed adjustments should be rejected for the following reasons:

a. The proposed adjustment is procedurally inappropriate.

b. The proposed adjustment is substantively inappropriate because it violates traditional depreciation theory, this Commission's precedent, intergenerational equity between generations of customers and the Federal Energy Commission's (FERC) guidance on accrual accounting.[87]

The last depreciation study conducted for the Company was as of September 30, 2014 and was submitted and approved by this Commission in Case No. 2015-00343.[88] That depreciation study was performed for the Company by witness Watson. No new depreciation study was undertaken for this proceeding. The current depreciation rates, including the methodology for determining net salvage, were part of a settlement agreement agreed by the Company and the OAG and approved by this Commission in Case No. 2015-00343.

Mr. Kollen attempts to avoid the precedent issue by saying the 2015 settlement agreement does not apply to the current proceeding and the OAG is not bound by that agreement.[89] While the Company acknowledges the 2015 settlement does not *per se* apply to this

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[85] Kollen Direct at 5.
[86] *Id.* at 55-56.
[87] Rebuttal Testimony of Dane Watson ("Watson Rebuttal") at 6; *see also Electronic Application of Duke Energy Kentucky, Inc. for: 1) An Adjustment of Electric Rates; 2) Approval of an Environmental Compliance Plan and Surcharge Mechanism; 3) Approval of New Tariffs; 4) Approval of Accounting Practices to Establish Regulatory Assets and Liabilities; and 5) All Other Required Approvals and Relief*, Order at 28, Case No. 2017-00321 (Ky. PSC Apr. 13, 2018).
[88] Watson Rebuttal at 4.
[89] Kollen Direct at 55, FN 48.

proceeding, it is important to note that Mr. Kollen filed testimony in the 2015 case and did not raise any issue or take any exception to any part of the depreciation study's recommendations or results, all of which would have occurred and been documented in testimony prior to the settlement agreement.[90]

Apparently, sometime following the 2015 settlement agreement, Mr. Kollen conceived the new so-called "third approach" to determining net salvage. Mr. Kollen introduced his new approach in the pending Duke Energy Kentucky proceeding in Kentucky PSC Case No. 2017-00321[91] and subsequently proposed it in this proceeding.

It is to be noted that unlike the present case, a current comprehensive depreciation study had been performed by Duke Energy for its rate case. No such study has been performed in this case – Mr. Kollen has simply chosen to take one aspect of the Company's existing depreciation rates and propose a radical change without the benefit of an updated comprehensive depreciation study.

As pointed out by Company witness Watson, making piecemeal changes to comprehensive depreciation studies can result in unintended consequences. Although Mr. Kollen has proposed revised net salvage factors, he failed to recognize that the depreciation study accrual Mr. Watson calculated in the existing study utilized a reserve allocation. Mr. Kollen has not performed the necessary update to the reserve allocation for his proposed changes.[92]

As stated above, Mr. Kollen testified there are "three approaches" to determining net salvage values. It appears that the Company and OAG agree that the Company uses the "first approach" consistent with long standing Commission precedent. Mr. Kollen continues that there

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[90] Watson Rebuttal at 45.
[91] Attorney General's Response to Atmos Energy's First Request, Item 39.
[92] Watson Rebuttal at 22.

is a "second approach" which includes no estimate of future net salvage. And, finally, the purported "third approach" which Mr. Kollen says is a compromise between the "first" and "second" approaches that includes net salvage but at a level based on recent net salvage.[93]

Although Mr. Kollen states that he recommends the "third approach" in his direct testimony in this case,[94] he says something completely different in subsequent discovery. When Mr. Kollen was asked to list all jurisdictions that he has recommended the "third approach" to net salvage he responded as follows:

> "RESPONSE:
>
> Objection. This requests misstates Mr. Kollen's testimony. Without waiving this objection, Mr. Kollen states that he did not recommend the third approach in this proceeding and has not recommended this approach in other gas utility proceedings. As noted in the response to question 40, Mr. Kollen merely described the third approach. It is not "his" approach. Mr. Kollen has recommended an approach similar to the third approach in a recent electric utility proceedings with respect to terminal net salvage on production plants accounts." (Emphasis added).[95]

It is unclear whether Mr. Kollen changed his mind or simply referenced the wrong "approach" in his response to Company DR 1-41. Either way, it is noteworthy that Mr. Kollen specifically stated he had not recommended this approach "…in other gas utility proceedings". He did, of course, recommend it in the Duke electrical case. For purposes of this Brief, Company will assume that Mr. Kollen is, in fact, recommending the "third approach".

As noted above, Mr. Kollen was asked to list all jurisdictions that he is aware of that have adopted the "third approach" to net salvage.[96] After objecting that the data request misstated his testimony, Mr., Kollen listed no jurisdiction that had adopted this approach.[97] Likewise, when asked to provide any authoritative texts that he was aware of that supported either his "second"

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[93] Kollen Direct at 55-56.
[94] *Id.* at 58.
[95] Attorney General's response to Atmos Energy's First Request, Item 41.
[96] *Id.* at Item 40.
[97] *Id.*

or "third" approach to net salvage, Mr. Kollen provided none.[98]

In short, when asked to provide any regulatory jurisdiction or authoritative texts that supported either the second or third approach to net salvage, Mr. Kollen provided none. By contrast, Company Witness Watson stated the "authoritative sources unanimously agree that projecting the cost to remove assets at the end of their lives is a necessary factor in establishing net salvage rates."[99] Watson was also able to quote and cite authoritative sources in support thereof.[100]

As to other regulatory jurisdictions, although Mr. Kollen could not list any jurisdiction that supported his approach, Mr. Watson cited and quoted from numerous jurisdictions that have affirmed and followed the traditional method (i.e. the "first approach") of determining net salvage used by the Company in this case.[101]

Mr. Kollen's recommended approach to calculating net salvage should also be rejected because it is inconsistent with FERC's guidance regarding the treatment of salvage and cost of removal in calculating depreciation expense and violates accrual accounting principles.[102]

Lastly, Mr. Kollen's approach should be rejected because it violates the ratemaking principal of intergenerational equity. Intergenerational equity is the long established ratemaking principle that customers receiving the benefit from the use of a utility's asset are the same customers who should pay for the cost of such assets.[103]

Under the traditional method used by the Company and historically approved by this Commission, the estimated removal cost required to remove assets at the end of their lives is

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[98] *Id.* at Item 42.
[99] Watson Rebuttal at 8.
[100] *Id.* at 9-10.
[101] *Id.* at 16-21.
[102] *Id.* at 12-13.
[103] *Id.* at 14.

accrued evenly or on a straight-line basis over the expected life of the assets.[104] Accruing a removal cost on a consistent basis over the useful life of the plant asset assures that the customers who benefit from that asset over the years will be paying their fair share of the ultimate cost of removal.

Under Mr. Kollen's approach, those customers who are using the asset at the end of or more likely after the end of its useful life will be paying a disproportionate share of the removal cost.[105] This fact is borne out by Mr. Kollen's own testimony that lower depreciation rates will exist in the earlier years of an assets life and greater depreciation rates in the latter years.[106]

F. RATE BASE

1. Cash Working Capital

The OAG asserts that the Company's cash working capital is overstated and should be reduced, based on certain "corrections" it proposes to the Company's lead/lag study. The quantitative effect of the OAG's proposed changes to the Company's cash working capital included in rate base is a reduction of $658,905 in the Company's revenue requirement.[107]

In accordance with the terms of the settlement reached in the Company's prior 2015 rate case, a lead/lag study was performed by Company Witness Christian. Mr. Kollen testified that the Company "incorrectly" included $5.953M of non-cash expenses in the calculation of cash working capital consisting of $1.087M of deferred federal income tax expense, $.069M of deferred state income tax expense $2.037 of depreciation expense and $2.490M return on equity.[108]

The amount of cash working capital included in rate base in this proceeding by the

[104] *Id.*
[105] *Id.* at 15
[106] Kollen Direct at 56.
[107] *Id.* at 5.
[108] *Id.* at 32.

Company was calculated under the one-eighth of O&M expense method which the Commission has approved in all Atmos Energy rate cases since it purchased Western Kentucky Gas in 1987.[109] The Company calculated cash working capital for both the base period and test period using both methods as follows:[110]

	Lead/Lag	1/8th O & M
Base Period	$3,411,800	$3,370,236
Test Period	$2,400,429	$3,270,504

Two issues are presented by the OAG's proposed adjustment relating to cash working capital:

1. Should the Commission's long-standing approval of the use of the 1/8th O&M expense method in all of Atmos Energy's prior rate cases in Kentucky be abandoned in favor of the results of the lead/lag study? And if so, would every rate case then require the filing of a lead/lag study by the Company?

2. If the Commission determines that the 1/8th O&M expense method should no longer be used, should the lead/lag study include non-cash items consisting of depreciation expense and return on equity?

The Company believes that the 1/8th O&M expense method remains a valid, well recognized and objective method for determining cash working capital. This approach was approved by the Commission in the Company's most recent fully litigated rate case.[111] Company witness Christian noted as follows:

"Q. IS THE FORMULA APPROACH OF 1/8 OF OPERATIONS AND MAINTENANCE EXPENSES A RECOGNIZED METHOD FOR DETERMINING CASH WORKING CAPITAL?

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[109] Rebuttal Testimony of Joe Christian ("Christian Rebuttal") at 1.

[110] Atmos Energy's response to Staff's Second Request, Item 32(a).

[111] *Application of Atmos Energy Corporation for an Adjustment of Rates and Tariff Modifications*, Order, Case No. 2013-00148 (Ky. PSC Apr. 22, 2014).

A. Yes. The formula approach used in this case is one of three methods discussed in Matthew Bender's Accounting for Public Utilities. This publication notes that the wide acceptance of the 1/8 formula resulted from the fact that it was determined to be a reasonable estimate of what a lead-lag study would produce without the related expense of a lead-lag study."[112]

In the recent Rate Order in Kentucky Power the Commission characterized the 1/8th O&M expense method as "…the Commission's long standing formula approach…."[113] The Company does not believe the OAG has established sufficient reason for the Commission to abandon its long standing precedent.

If the Commission determines that the Company's lead/lag study should be used in lieu of the 1/8th O&M expense method, the issue comes down to whether depreciation expense and return on equity are properly included. The Company believes that inclusion of these non-cash items is appropriate and Mr. Kollen argues they are not. When the Company makes an investment in an asset, that investment is included in rate base as net plant in service until depreciation is recorded on that asset. Recording depreciation removes the asset from rate base, even though cash has not been received to pay for the service provided by the asset unless that revenue lag on depreciation expense is included in cash working capital.[114]

As to the treatment of return on equity, like depreciation, there is again a revenue lag between the provision of service and the receipt of cash for that service. Mr. Kollen does not dispute that the rates billed to customers include a return component.[115] It is also not disputed that there is a lag between provision of service to customers and receipt of payment. The

[112] Direct Testimony of Joe Christian ("Christian Direct") at 9.
[113] *Electronic Application of Kentucky Power Company for (1) A General Adjustment of Its Rates for Electric Service; (2) An Order Approving Its 2017 Environmental Compliance Plan; (3) An Order Approving Its Tariffs and Riders; (4) An Order Approving Accounting Practices to Establish Regulatory Assets and Liabilities; and 5(An Order Granting All Other Required Approvals and Relief*, Order at 8, Case No. 2017-00179 (Ky. PSC Jan. 18, 2018).
[114] Christian Rebuttal at 14.
[115] *Id.*

Company's lead/lag study properly recognizes the resulting revenue lag on recovering cash related return by including return on equity with a zero expense lag.[116]

Mr. Kollen does not just offer his opinion that these non-cash items should not be included, he goes so far as to assert that it is an "error" to include them.[117] Specifically, Mr. Kollen states, in discussing the Company's lead/lag study filed in Tennessee, "…that study "erroneously" included amounts for non-cash depreciation and return on equity.[118] Mr. Kollen testifies that if "correctly calculated" the Company's lead/lag studies result in a negative Cash Working Capital requirement.[119]

Mr. Kollen's statements overlook the fact the Company's lead/lag study was filed with the Commission in Tennessee and was approved by the Tennessee Public Utility Commission (TPUC).[120] Utilizing the methodology approved by the TPUC, the Company's lead/lag results in a positive cash working capital balance of $2.4 million.[121] These results are not "erroneous." They are accepted by the regulatory authority in Tennessee.

2. ADIT (NON-NOLC)

Mr. Kollen proposes three adjustments related to ADIT.[122] Two of those adjustments relate to certain deferred tax assets ("DTAs") which he divides into two categories. The third adjustment is related to the DTA for the Company's net operating loss carryover ("NOLC") and is discussed separately in Section X of this Brief. Mr. Kollen testifies that the first and second categories are removed because in general the DTAs are related to costs that are not recovered through the ratemaking process and that the Company failed to subtract the associated liability from rate

[116] *Id.* at 16.
[117] Kollen Direct at 32-33.
[118] *Id.* at 33.
[119] *Id.* at 34.
[120] Christian Rebuttal at 12-13.
[121] *Id.* at 13.
[122] Kollen Direct at 12-13.

base.[123] Mr. Kollen goes on to note that the Company has agreed to remove certain of the identified items.[124]

Mr. Christian explains errors in Mr. Kollen's arguments relating to the appropriateness of the remaining two category 1 adjustments that are beyond what was agreed to in discovery as well as the liabilities associated with category 2 deferred tax assets in this section.[125] The Company disagrees with Mr. Kollen's adjustments to two DTA items related to self-insurance and benefits accruals. The Company included adjustments in Exhibit GKW-R-1 reflecting the removal of the five category one items. However, due to the TCJA the ADIT has also been updated by the Company in Exhibit GKW-R-1, thus it has had an impact on the amount of adjustment for the items that both parties agree need to be removed from rate base.

As indicated in response to AG 1-33(b) and AG 1-34(c) the category 2 items are associated with Employee Welfare expenses consistent with prior cases, including Case Nos. 2013-00148 and 2015-00343. As expenses in the revenue requirement, inclusion of the DTA is appropriate. Mr. Kollen recommends that the Commission either deduct the associated liabilities from rate base or remove the DTAs from rate base. In his calculation of the revenue requirement impact of his recommendations, he chooses the former option by calculating the impact of removing the liabilities from rate base, which the Company believes is improper ratemaking.[126]

The Company has rates approved in the eight states it serves and makes no such adjustment in any of its jurisdictions. Mr. Kollen testified against the Company in Docket Nos. 20298-U, 27163, and 30442 in the Company's former Georgia jurisdiction and did not propose this adjustment. The Company is unaware of this treatment being applied to any gas utility in Kentucky and furthermore, it is inconsistent with the rates approved by this Commission in Case No. 2013-

[123] Kollen Direct at 13-14.
[124] *Id.* at 15; *See also* Atmos Energy's responses to AG's First Request, Items 33-35.
[125] Christian Rebuttal at 8-11.
[126] Kollen Direct at 13.

00148. The proper ratemaking for liabilities such as the ones in question is to include them in rate base. Timing differences between the time an expense is booked and cash paid are netted against timing differences between the time revenues are billed and cash received. The net result of these timing difference comprise a utility's cash working capital requirement which is properly included in rate base.[127]

3. Non-PRP Capital Expenditures

Mr. Kollen makes an adjustment for non-PRP capital expenditures by removing the twelve percent increase projected by the Company for the months of October 2018 through March 2019. Mr. Kollen's argues that the twelve percent increase outpaces projected inflation and that the Company would not be obligated to spend the capital if it were included in revenue requirement.[128] Mr. Kollen's adjustment is not consistent with the Company's planned capital investment. The twelve percent increase is solely projected for the months of the forward looking test year that are in FY 2019, is based on growth in capital spending beyond the Company's FY 2018 budget, and is not related to nor a function of expected inflation rates, but rather is consistent with the Company's five year financial plan.[129] The Company's FY 2018 non-PRP capital investment budget can be found in the Plant Data model workpapers to the response to Staff's First Request, Item 71. These projected increases in direct investment reflect actual and expected capex growth consistent with the operational needs of the Company's Kentucky distribution property. The Company's response to Staff's Second Request, Item 16, Attachment 1 also indicates that year-over-year capital spending increases have occurred in the past several years for Kentucky as a whole and that the Company has experienced minimal variances to budget.

The consistency of budgeted investment to actual investment confirms the Company's

[127] Christian Rebuttal at 10.
[128] Kollen Direct at 7-8.
[129] Atmos Energy's response to Staff's Second Request, Item 17.

position that investment is need-based rather than inflation-based. Mr. Kollen's suggestion that the Company would not spend the additional capital once it was included in revenue requirement ignores the fact that the Company's system of internal controls and accountability ensures that the opposite is true. The Company's past performance also bears out that it spends budgeted capital amounts and in the past two years has actually spent more than budgeted amounts.[130] Failure to base rates on an increased level of capital spending when that is, in fact, the Company's investment plan and the needs of the system to ensure safety and reliability, puts pressure on the Company to increase its frequency of general rate cases absent a comprehensive annual rate mechanism such as the one proposed by the Company in this case.[131]

4. Prepaids

The Company agrees with Mr. Kollen and has removed prepaids in Mr. Waller's Exhibit GKW-R-1.[132]

G. CAPITAL STRUCTURE

1. Senior Debt – Imputed Interest

The OAG recommends through both Mr. Baudino and Mr. Kollen inclusion of an imputed 4% interest rate of the expected new debt issue scheduled for March 2019, rather than using the current 8.5% current rate in calculating Atmos Energy cost of debt.[133] Additionally, this proposal annualizes the debt at 4% over ten years.

Atmos Energy did not make an adjustment to the rate because the terms of potential financing were not known at the time of the filing and cannot be estimated until closer to the time the loan is due to mature in March 2019. The term of the loan will be in effect for each month of

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[130] *See Id.* at Item 16.
[131] Waller Rebuttal at 3-4.
[132] Kollen Direct at 36; *see also* Christian Rebuttal at 15.
[133] Kollen Direct at 53; Direct Testimony of Richard Baudino ("Baudino Direct") at 30.

the forecast test period.[134] Atmos Energy continuously reviews market conditions and rates to determine the most favorable conditions. However, in this situation, the penalties for re-financing are too severe to justify such action.[135]

At the hearing, Mr. Christian explained that the current interest rate was not annualized, but one-half month of the estimated savings from the re-financing is included in the calculation of Atmos Energy's debt through a blended interest rate embedded in the test year based on a hypothetical refinancing.[136] The OAG's proposal is not reasonable because it does not account for the pre-payment penalties in the proxy statement.[137] For example, there is a 50 basis point adder to the early redemption of the debt. Atmos Energy cannot simply refinance today without a significant penalty.[138] There is also a one-year interest penalty and treasury swaps depending on the 30 year Treasury rates.[139] Considering these factors, Mr. Kollen's proposal does not allow recovery of the actual expense that will be incurred over the next 12 months.[140]

H. OTHER

1. Rate Case Expenses

Any utility may file an application for a rate adjustment at its discretion. KRS 278.180-190. Kentucky law allows a utility to recover its prudent costs of service and establish fair, just and reasonable rates. Mr. Kollen's adjustment to disallow all Atmos Energy rate case expense is based on his unsubstantiated belief that the Company's filing is unwarranted simply because he disagrees with the issues listed in his testimony.[141] Mr. Kollen made the same argument in

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[134] Atmos Energy's response to AG's First Request, Item 40.
[135] March 22, 2018, Video Transcript of Evidence at 3:50:45.
[136] *Id.* at 3:36:50.
[137] *Id.* at 3:37:11.
[138] *See* Atmos Energy's Response to AG's First Request, Item 40 Attachment 1 (Page S-14 (pdf 31 of 95). Under optional redemption, 2nd bullet at the top at the end of the sentence it discusses the 'plus 50 basis points' adder to the redemption price).
[139] March 22, 2018, Video Transcript of Evidence at 3:37:25; these items are quantified in Atmos Energy's response to Staff's PH-DR, Item 8.
[140] March 22, 2018, Video Transcript of Evidence at 3:38:55.
[141] Kollen Direct at 38.

Atmos Energy's previous rate case.[142]

In addition to cost of service items, the Company has also filed for approval of an ARM, as well as an update to the R&D Rider in this case. Currently, the Company has no way of recovering non-PRP investments, resetting billing determinants and approving other items, such as the R&D Rider, except through a general rate case. All these costs were reasonably and prudently incurred. To disallow the Company recovery of the expense is not only unfair, but conflicts with both United States Supreme Court and Commission precedent. The Commission has stated that "[r]ate case expenses have long been considered as appropriate expenses for inclusion in utility rates."[143] This is consistent with the United States Supreme Court, which has held that such expenses "must be included among the costs of operation in the computation of a fair return," and that the "charges of engineers and counsel, incurred in defense of its security and perhaps its very life, were as appropriate and even necessary as expenses to recover in any rate proceeding."[144]

More recently, the Commission approved rate case expenses in Application of Monroe County Water District for Rate Adjustment, Case No. 2017-00070: "A utility may properly recover reasonable rate case expenses as a cost of doing business"[145]

If approval of rate case expenses is predicated on the OAG's agreement with the proposed rate adjustments in the application, given the OAG's past opposition to rate increases, no utility would ever recover incurred rate case expenses, no matter how reasonable those

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[142] *Application of Atmos Energy Corporation for an Adjustment of Rates and Tariff Modifications*, Direct Testimony of Lane Kollen at 32-33, Case No. 2015-00343 (Ky. PSC April 15, 2016).
[143] *In the Matter of: Proposed Adjustment of the Wholesale Water Service Rates of the City of Owenton, Kentucky*, Order, Case No. 98-283 (Ky. PSC Feb. 22, 1999).
[144] *West Ohio Gas Co. v. Public Utilities Comm'n*, 294 U.S. 63, 74 (1935).
[145] *Driscoll* v. *Edison Light & Power Co., 307 U.S. 104. 120 (1939); see also*, *In the Matter of the Application of Big Rivers Electric Corporation for an Adjustment in Rates,* Order, Case No. 2012-00535 (Ky. PSC. Oct. 29, 2013); *In the Matter of the Application of Meade County Rural Electric Cooperative Corporation to Adjust Electric Rates*, Order. Case No. 2010-0022 (Ky. PSC Feb. 17, 2011) *(*allowing rate case expenses based on the most recent actual costs filed by the utility)

expenses may have been. The Company's rate case expenses are a cost of doing business for the Company, and the Company respectfully requests this Commission for both approval of these expenses and the amortization of these expenses to be included in the final order in this case. This approval within the final order is required by the Company for audit purposes in order to recognize rate case expenses as a regulatory asset.

VII. PIPE REPLACEMENT PROGRAM RIDER

The Company's forward-looking PRP was the result of a unanimous settlement with the OAG's office and approved by the Commission in Case No. 2009-00354. After expressing no objection to the Company's first seven PRP filings, the OAG, through Mr. Kollen, is recommending for the first time to terminate or cap the Company's PRP Rider.[146] The Company views termination of the PRP as ill-advised and short-sighted. According to the American Gas Association, forty-one (41) states, including the District of Columbia, have specific rate mechanisms that foster accelerated pipe replacement.[147] Indeed, safety regulators such as the administrator of the U.S. Pipeline and Hazardous Materials Safety Administration have expressed their desire for more regulatory support at the state level for safety activities such as the PRP.[148] The Company's PRP is a safety program with the purpose of accelerating the replacement of aging infrastructure. Atmos Energy is one of many utilities to have a PRP in Kentucky or the United States and the PRP allows the Company to be proactive in modernizing its system and actively reduce risk of future failure. Providing safe and reliable gas service to all of its customers is Atmos Energy's most fundamental objective. The Company is acutely aware that its actions can directly impact the safety of its customers, communities and employees. The importance of

[146] Kollen Direct at 74.
[147] Rebuttal Testimony of Mark Martin ("Martin Rebuttal") at 9; *see also* Atmos Energy's response to AG's First Request, Item 1.
[148] *Id.*

focusing on safety is magnified when one considers the natural gas incidents that have resulted in loss of life, injuries, and damage to property.[149]

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 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.[150]

Since beginning the PRP in mid-2011, Atmos Energy has used the program to accelerate the replacement of mains and services. These replacements target aging infrastructure and enhance the safety and reliability of gas supply for the communities Atmos Energy services. The meter sets have been replaced with new meters or regulators and relocated to accessible location for meter reading or emergency response. The new service lines have been installed with excess-flow devices which add an enhanced level of safety for our customers. In several instances, entire low-pressure systems have been eliminated which improves service reliability. Atmos Energy has invested in new technology that allows detailed mapping of these replacement projects showing service detail and ensuring locatability using wireless marking devices. Atmos Energy has completed infrastructure replacement in many of our service territories including: Bowling Green, Russellville, Horse Cave, Cave City, Glasgow, Mayfield, Munfordville, Hopkinsville, Owensboro, Paducah, Marion, Madisonville, Princeton, Campbellsville, Sebree, Dawson Springs, Crofton, Shelbyville, Harrodsburg and Lancaster.[151]

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[149] Atmos Energy's response to AG's First Request, Item 1.
[150] *Id.*
[151] Waller Direct at 15.

The PRP Program Management works continuously with local management and engineering to identify which qualifying projects will be scheduled for replacement each fiscal year. Based on approved capital dollars, filed annually with the Kentucky PSC, the Company plans projects according to many factors including:

> Analysis of recent leak surveys and leak history on remaining bare steel systems
>
> Recommendations by local SME and engineering on what would be the best use of capital for reduced O&M and system improvement
>
> Deployment of Company and contract crews, project inspectors, warehouse materials, and the ability to mobilize between separate locations
>
> Local impact to cities and municipalities based on local resources needed to support (locating, planning and zoning inspection, local plans for street overlay / downtown revitalization, and logistical issues such as availability of asphalt for street repairs, etc.)[152]

The Company was asked in Case No. 2017-00308, the most recent PRP annual filing, in which the Commission approved a $45 million capital expenditure program, to forecast its future PRP spending.[153] The Company's best estimate possible was to assume a twelve percent (12%) growth factor on the projected 2018 spend. This estimated growth factor makes the future PRP spending projections quite large. The fiscal year 2018 direct capital budget for Kentucky of $77.02 million includes the Company's planned PRP investment for all 12 months of fiscal 2018. The $63.15 million referenced in Mr. Waller's testimony is the total amount of test year capital investment included in revenue requirement including allocated capital investment from Shared Services and the Division General Office. It includes only 6 months of PRP investment (April 1 - September 30, 2018) and excludes PRP investment planned for the final 6 months of the test period

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[152] March 22, 2018, Video Transcript of Evidence at TR 1:09:54.

[153] *See* Atmos Energy's response to AG's First Request, Item 48; *see also* Atmos Energy response to Staff's Second Request, Item 18.

(October 1, 2018 - March 31, 2019) as discussed in Mr. Waller's testimony at page 16, lines 1-21.

The 12% factor used to project capital investment for Kentucky for fiscal year 2019 (representing 12% growth over the level budgeted for FY18) is consistent with the Company's five-year financial plan presented to the Company's Board of Directors in September 2017.[154] This same estimate for total capital spending in Kentucky was used for the forecasted PRP budgets for years 2015 through 2025. As Mr. Waller discussed at the hearing, the 12% estimate is not the amount for PRP, but for all capital spending.[155] The PRP budget fluctuates based on the need for and priority of the various projects.[156] The spend for PRP for 2011 through 2025 is based on actual identified projects.[157]

The twelve percent increase is solely projected for the months of the forward looking test year that are in FY 2019, is based on growth in capital spending beyond the Company's FY 2018 budget, and is not related to nor a function of expected inflation rates.[158] As stated earlier, the projected increases in direct investment reflect actual and expected CapEx growth consistent with the operational needs of the Company's Kentucky distribution property. The Company's response to Staff's Second Request, Item 16, Attachment 1 also indicates that year-over-year capital spending increases have occurred in the past several years for Kentucky as a whole and that the Company has experienced minimal variances to budget.

The consistency of budget to actual investment confirms the Company's position that investment is need-based rather than inflation-based. Mr. Kollen's suggestion that the Company would not spend the additional capital once it was included in revenue requirement ignores the fact that the Company's system of internal controls and accountability ensures that the opposite is true. Failure to base rates on an increased level of capital spending when that is, in fact, the

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[154] Atmos Energy's response to Staff's Second Request, Item 17; *see also* Atmos Energy's response to AG's First Request, Item 15.
[155] March 22, 2018, Video Transcript of Evidence at 2:37.
[156] *Id.* at 2:38.
[157] *Id.* at 1:17:30.
[158] *Id.* at 4:24.

Company's investment plan, puts pressure on the Company to increase its frequency of general rate cases absent a comprehensive annual rate mechanism such as the one proposed by the Company in this case. Further, the Company's forecasted PRP expenses have no actual bearing on the Company's revenue requirement or the base rates to be determined in this proceeding. The Company's PRP rates that do go into effect only reflect actual planned projects that are entered into after consultation with the Commission.

As explained in Atmos Energy's response to Staff's Second Request, Item 18, the original estimate of $124 million for PRP is now over ten years old. Additionally, there were assumptions made within this original estimate that have proved to be incorrect. A few of the more significant differences relate to (1) the cost of service line and meter loop replacement; (2) the cost of Crossbore Inspection Services; (3) the estimated engineering design, project management, and mapping cost associated with these replacement projects; (4) the underestimation of the cost of large diameter high-pressure and transmission lines within the program.[159] In general, these construction cost were all estimated at $400k / mile and the actual cost for replacement has been approximately $628k / mile for distribution and range from $1,100k to $2,000k / mile for HPD/Transmission depending on the size of pipeline being installed.[160] Current project costs have increased also due to the type of projects, length of pipe replaced, and other factors associated with those projects that were not included in the original estimates.[161] The Company has actual project costs and estimates each project based on those costs and the size and type of project.[162] The costs are reasonable because the PRP program has been competitively bid.[163]

The current procedure is to replace almost all the service lines attached to main associated with PRP unless the service is made of MDPE/HDPE, includes an anodeless riser, has a fully

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[159] Atmos Energy's response to Staff's Second Request, Item 18.
[160] *Id.*; *See also* Rebuttal Testimony of Greg Smith ("Smith Rebuttal") at 8; *see also* March 22, 2018, Video Transcript of Evidence at 1:06:37.
[161] March 22, 2018, Video Transcript of Evidence at 1:17:30.
[162] *Id.* at 1:17:35; 1:18:40.
[163] *Id.* at 1:18:50.

compliant meter set, and is fully tonable/locatable. All service replacements are completed back to the tap on the main and include an EFV or isolation valve as required by code. The Company maps all services replaced under the PRP program using specified GPS points, electronic marking devices, tie-in photography, and field sketches during the time of installation and electronically scanned as part of the permanent record for the work completed. These costs are captured as part of each PRP project and are included in the PRP revenue requirement.[164]

The Commission's Order in Case No. 2014-00274 stated that "KRS 278.509 does not mandate that natural gas pipeline replacement programs be restricted to bare steel or 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."[165] It should also be noted that the Commission, in discussing the parameters of the Company's PRP in its Order in Case No. 2014-00274, quoted from the direct testimony of Gary Smith, Atmos Energy's Director of Rates and Regulatory Affairs, as follows: "The PRP would also <u>include</u> replacement of service lines, curb valves, meter loops and any mandated relocates."[166] The Commission also quoted from the direct testimony of Earnest B. Napier, PE, Vice President of Technical Services for Atmos Energy's Kentucky/MidStates Division, in describing the pipe replacement components that Atmos Energy proposed to include in its PRP:

> Atmos will be taking steps to ensure that the newly installed facilities are appropriately designed and sized. **This may necessitate in certain circumstances the replacement of facilities other than bare steel mains and services and those planning, design, replacement construction, investment and retirement costs will be included in the PRP as well** (emphasis added).[167]

The Commission specifically found that Atmos Energy's PRP covered not only the

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[164] Atmos Energy's response to Staff's Second Request, Item 19.
[165] *Application of Atmos Energy Corporation to Establish PRP Rider Rates for the Twelve Month Period Beginning October 1, 2014*, Order at 6, Case No. 2014-00274 (Ky. PSC Oct. 10, 2014).
[166] *Id.* at 4.
[167] *Id.* at 5.

replacement of bare steel, but also "…the replacement of facilities other than bare steel mains and services."[168] The Commission then concluded that: "Thus, other pipe replacements such as the replacement of the Shelbyville line may be included."[169] The Shelbyville Line project, as approved by the Commission for inclusion in the PRP, included replacement of regulator and metering stations, network and other values and remote monitoring - the same type of facilities being questioned by the OAG in the above request.[170]

There are some outside factors which may cause delays to PRP projects into later years. The ability/difficulty in getting easements from landowners, construction that is weather sensitive such as the replacement of regulator stations and high-pressure pipelines, low pressure systems that require temporary feeds that (in turn) depend on a preceding project to be accomplished are examples.[171] In his testimony at the hearing, Mr. Smith, discussed how projects are prioritized, bid and scheduled.[172]

Because the forward-looking forecasts for O&M expenses in this docket are based on the Company's most recently completed budget, to the extent savings have been realized they are reflected in that budget and therefore in this docket.[173] Other efficiencies would be captured in budgeting process and captured in any forecast.[174]

Since the PRP's inception, there has been a measurable reduction in leaks, which has enhanced the safety of the pipeline facilities. The number of leaks has declined each year of the PRP from 1,127 in 2011 to 528 through August of 2017.[175]

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[168] *Id.* at 6.
[169] *Id.*
[170] Atmos Energy's response to AG's Second Request, Item 15.
[171] *See* Atmos Energy's response to Staff's Second Request, Item 18(b).
[172] March 22, 2018, Video Transcript of Evidence at 1:10.
[173] Atmos Energy's response to Staff's Second Request, Item 23.
[174] March 22, 2018, Video Transcript of Evidence at 3:54.
[175] Atmos Energy's response to Staff's Second Request, Item 18.

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

OAG witness Kollen suggested an annual cap on PRP spending.[176] If the Commission were to consider holding the level of PRP investment constant at 2018 levels (*i.e.* $44.9m), the Company would need 3.5 additional years (beyond 2025) to complete the replacement of the original program as outlined in Case No. 2009-00354 as well as the additional 100 miles of bare steel that was discovered in 2011.[177] Without an annual mechanism, the Company's PRP program is the best mechanism to replace pipe that has outlived its useful life and/or creates a safety and/or a reliability concern. As the Company stated in Case No. 2017-00308, while no additional types or families of pipe, or segments thereof, have been added to the Company's PRP, the Company may seek to add additional types or families of pipe, or segments thereof, in the future. The Company is aware of additional types or families of pipe that may need to be added to the PRP program in the future. Such examples would include, but are not limited to, Aldyl-A plastic pipe as well as unwired plastic pipe. The inclusion of additional types or families of pipe in the PRP may create the need for an extension of the PRP.[178]

VIII. RATE OF RETURN

[176] Kollen Direct at 72.
[177] Atmos Energy's response to Commission Staff's Fourth Request for Information ("Staff's Fourth Request"), Item 9.
[178] *Id.*

Atmos Energy, through its expert witness, Dr. James Vander Weide, Ph.D., initially recommended a return on equity of 10.3 percent. That was subsequently adjusted to 10.6 percent.[179] This conclusion was based on the results of the application of standard cost of equity estimation techniques, including the DCF model, the ex ante risk premium approach, the ex post risk premium approach and the CAPM, to a broad group of utilities of comparable business risk. His initial recommendation of 10.3 percent was considered conservative because the financial risk of the comparable companies he analyzed, which is based on the equity ratio resulting from the market values of their equity and debt, is less than the financial risk of the lower equity ratio in Atmos Energy's ratemaking capital structure, which is based on its book values of equity and debt.[180]

Dr. Vander Weide relied on the principles stated in *Bluefield Water Works and Improvement Co. v. Public Service Comm.*, 262 U.S. 679, 692 (1923).

> A public utility is entitled to such rates as will permit it to earn a return upon the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economical management, to maintain and support its credit, and enable it to raise the money necessary for the proper discharge of its public duties.

The Court recognizes that: (1) a regulated firm cannot remain financially sound unless the return it is allowed to earn on the value of its property is at least equal to the cost of capital (the principle relating to the demand for capital); and (2) a regulated firm will not be able to

[179] March 22, 2018, Video Transcript of Evidence at 10:57:00; *see also* Atmos Energy's response to Staff's PH-DR, Item 10.
[180] Direct Testimony of James Vander Weide ("Vander Weide Direct") at 3-4.

attract capital if it does not offer investors an opportunity to earn a return on their investment equal to the return they expect to earn on other investments of the same risk (the principle relating to the supply of capital).

In *Hope Natural Gas, supra*, the Court reiterates the financial soundness and capital attraction principles of *Bluefield Water Works*, *supra*: “From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock... By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.”[181]

The Court clearly recognizes that the fair rate of return on equity should be: (1) comparable to returns investors expect to earn on other investments of similar risk; (2) sufficient to assure confidence in the company's financial integrity; and (3) adequate to maintain and support the company's credit and to attract capital.

Dr. Vander Weide used several generally accepted methods to arrive at his recommended return on equity. These are the DCF, the ex ante risk premium, the ex post risk premium, and the CAPM. The DCF method assumes that the current market price of a firm's stock is equal to the discounted value of all expected future cash flows. The ex ante risk premium method assumes that an investor's expectations regarding the equity risk premium can be estimated from data on the DCF expected rate of return on equity compared to the interest rate on long-term bonds. The ex post risk premium method assumes that an investor's expectations

[181] *Federal Power Comm'n v. Hope Natural Gas Co*., 320 U.S. 591, 603 (1944); *see also* Vander Weide Direct at 8-9.

regarding the equity-debt return differential are influenced by the historical record of comparable returns on stock and bond investments. The cost of equity under both risk premium methods is then equal to the expected interest rate on bond investments plus the expected risk premium. The CAPM assumes that the investor's required rate of return on equity is equal to an expected risk-free rate of interest plus the product of a company-specific risk factor, beta, and the expected risk premium on the market portfolio.[182]

The annual DCF model is only a correct expression for the present value of future dividends if dividends are paid annually at the end of each year. Because the companies in Dr. Vander Weide's comparable group all pay dividends quarterly, the current market price that investors are willing to pay reflects the expected quarterly receipt of dividends. Therefore, a quarterly DCF model should be used to estimate the cost of equity for these firms. The quarterly DCF model differs from the annual DCF model in that it expresses a company's price as the present value of a quarterly stream of dividend payments. A complete analysis of the implications of the quarterly payment of dividends on the DCF model is provided in Exhibit JVW-1, Appendix 1. The results of the quarterly DCF model are approximately equal to the results of a properly applied annual DCF model (in which the end-of-year dividend is estimated by multiplying the current annual dividend by the factor one plus the growth rate).[183] The proxy group consists of all the natural gas utilities followed by Value Line that: (1) paid dividends during every quarter of the last two years; (2) did not decrease dividends during any quarter of the past two years; (3) have an available positive I/B/E/S long-term growth forecast; (4) have an investment grade bond rating and a Value Line Safety Rank of 1, 2, or 3; and (5) are not the subject of a merger offer that has not been completed.[184]

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[182] Vander Weide Direct at 16.
[183] *Id.* at 20.
[184] *Id.* at 26.

The risk premium method is based on the principle that investors expect to earn a return on an equity investment that reflects a "premium" above the interest rate they expect to earn on an investment in bonds. This equity risk premium compensates equity investors for the additional risk they bear in making equity investments versus bond investments. Dr. Vander Weide used two methods to estimate the required risk premium on an equity investment in publicly-traded natural gas utilities. The first is called the ex ante risk premium method and the second is called the ex post risk premium method.[185] With this analysis, the expected return on equity is in the range 9.8 percent to 10.4 percent, with a midpoint of 10.1 percent. Adding a 14 basis-point allowance for flotation costs, the estimate is 10.2 percent as the ex post risk premium cost of equity.[186]

The CAPM is an equilibrium model of the security markets in which the expected or required return on a given security is equal to the risk-free rate of interest, plus the company equity "beta," times the market risk premium. The CAPM requires an estimate of the risk-free rate, the company-specific risk factor or beta, and the expected return on the market portfolio. For the estimate of the expected risk premium on the market portfolio, Dr. Vander Weide used two approaches. First, an estimate of the risk premium on the market portfolio using historical risk premium data reported in the *2017 valuation handbook* for the years 1926 through 2016, data which are consistent with the data previously reported by Ibbotson® SBBI®. Second, an estimate of the risk premium on the market portfolio from the difference between the DCF cost of equity for the S&P 500 and the forecasted yield to maturity on 20-year treasury bonds.[187] One caution is that the CAPM tends to underestimate the cost of equity for small market capitalization companies, such as many of the natural gas utilities, and for companies whose betas are less than 1.0. The average of the three historical CAPM results is 10.2 percent (9.5 percent + 10.6 percent +

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[185] *Id.* at 27-28.
[186] *Id.* at 34.
[187] *Id.* at 35.

10.6 percent) ÷ 3 = 10.2 percent). (Vander Weide direct p. 38-42) Based on the most current information, Dr. Vander Weide updated his recommended ROE to 10.6.[188]

While he used the same methodologies as the OAG's witness, Dr. Vander Weide's results were notably different. He details several of his significant disagreements with Mr. Baudino's analysis in his rebuttal testimony. First, he explains the error in Mr. Baudino's use of Value Line's forecasted dividend per share growth rate to estimate the growth component of the DCF model. Dividend growth forecasts are, in general, less accurate indicators of long-run future growth than are earnings growth forecasts. When analysts forecast dividend growth, they first must estimate earnings growth and then forecast the percentage of earnings that will be paid out as dividends. Since the percentage of earnings that are paid out as dividends is uncertain, there is an additional element of error present in dividend growth forecasts than is present in earnings growth forecasts. In addition, his studies indicate that analysts' EPS growth forecasts are more highly correlated with stock prices than analysts' DPS growth forecasts. This result is important because it supports the conclusion that investors use analysts' EPS growth forecasts as the estimate of future growth when making stock buy and sell decisions.[189]

Another of Mr. Baudino's errors as described by Dr. Vander Weide is his assertion that "flotation costs are already accounted for in current stock prices...."[190] Dr. Vander Weide provides the analysis disproving this mistaken notion. Flotation costs are an expense that is deducted from the proceeds associated with a stock issuance before the proceeds are distributed to the issuing company. Because the stock price reflects the return on the amount of cash actually invested by the company and flotation costs are deducted from the proceeds of a stock issuance prior to the distribution of the net proceeds to the company, flotation costs are not included in the

[188] March 22, 2018, Video Transcript of Evidence at 10:57:00; *see also* Atmos Energy's response to Staff's PH-DR, Item 10.
[189] Rebuttal Testimony of James Vander Weide ("Vander Weide Rebuttal") at 5.
[190] Baudino Direct at 34.

stock price. Dr. Vander Weide includes flotation costs in his calculation of the company's cost of equity because the company will not be able to earn a fair return on equity if flotation costs are not included in the estimate of the cost of equity. His recommended flotation cost allowance is based on the fundamental economic and regulatory principles that: (1) a company should only invest in a new project if it can earn a return on its investment that is equal to or greater than its cost of capital; and (2) the time pattern of expense recovery should match the time pattern of benefits resulting from the expense. Because equity flotation costs are a legitimate expense of raising capital, a company has no incentive to invest in new capital projects if equity flotation costs are not included in the cost of capital estimate. In addition, because the proceeds of an equity issuance are invested in assets that provide benefits over a long time period, the costs of an equity issuance should be recovered over a long period of time.[191]

All firms that have sold securities in the capital markets have incurred some level of flotation costs, including the costs of underwriters' commissions, legal fees, and printing expense, for example. These costs are withheld from the proceeds of the stock sale or are paid separately and must be recovered over the life of the equity issue. Costs vary depending upon the size of the issue and the type of registration. Previously incurred flotation costs have not been recovered in previous rate cases; rather, they are a permanent cost associated with past issues of common stock. Just as an adjustment is made to the embedded cost of debt to reflect previously incurred debt issuance costs (regardless of whether additional bond issuances were made in the test year), so should an adjustment be made to the cost of equity regardless of whether additional stock was issued during the test year.[192]

Mr. Baudino's exclusion of flotation costs is inconsistent with and contrary to the

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[191] Vander Weide Rebuttal at 6-7.
[192] *Id.* at 9.

financial authority he relies on and cites in his testimony. On page 9 of Mr. Baudino's Direct Testimony, he refers to Morin's New Regulatory Finance, Public Utilities Reports, Inc. (2006) as authority for his discussion of interest rates. However, he fails to cite Dr. Morin's book when discussing floatation costs. The reason is obvious – Dr. Morin devotes the entire Chapter 10 of the same book explaining the necessity to make an adjustment to the cost of capital to account for floatation costs. "The costs of issuing these securities are just as real as operating and maintenance expenses or costs incurred to build utility plants, and fair regulatory treatment must permit recovery of these costs."[193] This selective use of Dr. Morin's book, exposes the weakness of Mr. Baudino's argument and undermines his credibility.

Another area of disagreement is Mr. Baudino's determination of Atmos Energy's cost of equity. Dr. Vander Weide disagrees with Mr. Baudino's: (1) use of the current yields on both five-year Treasury notes and twenty-year Treasury bonds to estimate the risk-free rate; (2) use of current Treasury yields rather than forecasted bond yields; (3) use of both geometric mean and arithmetic mean historical returns on the S&P 500 to estimate the market risk premium; (4) failure to recognize that the CAPM underestimates the cost of equity for companies with betas less than 1.0; and (5) failure to recognize that the CAPM underestimates the cost of equity for companies in his proxy group with small market capitalizations.[194]

He also disagrees with Mr. Baudino's use of current yields on Treasury securities to estimate the risk-free rate component of the CAPM because current yields on Treasury securities are artificially low as a result of the Federal Reserve's efforts to stimulate the economy. Dr. Vander Weide recommends using the forecasted interest rate on long-term Treasury bonds rather than current interest rates to estimate the risk-free rate component of the CAPM because current

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[193] Roger A. Morin, *New Regulatory Finance*, Public Utilities Reports, Inc. (2006) at 321.
[194] Vander Weide Rebuttal at 11-12.

interest rates have been determined more by Federal Reserve policy interventions than by market forces. Thus, forecasted interest rates are better indicators of investor-required returns on Treasury securities in the market place over the period during which the Company's rates will be in effect. At the time of filing his direct testimony, the forecasted yield on 20-year Treasury bonds was approximately 4.2 percent, whereas Mr. Baudino's CAPM studies use a Treasury bond yield equal to 2.59 percent.[195]

Mr. Baudino also fails to adjust for the tendency of the CAPM to underestimate the cost of equity for companies with betas less than 1.0, while Dr. Vander Weide supports such an adjustment by citing empirical evidence that the CAPM tends to underestimate the cost of equity for companies with betas less than 1.0. The original evidence that the unadjusted CAPM tends to underestimate the cost of equity for companies whose equity beta is less than 1.0 and to overestimate the cost of equity for companies whose equity beta is greater than 1.0 was presented in a paper by Black, Jensen, and Scholes, "The Capital Asset Pricing Model: Some Empirical Tests." Numerous subsequent papers have validated the Black, Jensen, and Scholes findings, including those by Litzenberger and Ramaswamy, Banz, Fama and French, and Fama and MacBeth.[196] Mr. Baudino cites no comparable authority for his suppositions.

Dr. Vander Weide used both the average Value Line beta for comparable companies and the 0.90 beta estimated based on the ratio of the long-term average risk premium on utility stocks compared to the average risk premium on an investment in the S&P 500.[197] Mr. Baudino argues that Dr. Vander Weide's use of a 0.90 beta along with a 0.74 beta is inappropriate because: (1) using a 0.90 beta assumes that "utility stocks are more volatile relative to the market as a whole than they really are;" and (2) "realized returns and risk premiums may not be indicative of

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[195] *Id.* at 13.
[196] *See* Vander Weide Direct at 39; *see also* Vander Weide Rebuttal at 14.
[197] *See* Vander Weide Direct at 41-42.

investor expectations and future return requirements".[198] Mr. Baudino is not correct when he asserts that use of a 0.90 beta assumes that "utility stocks are more volatile and more risky relative to the market as whole than they really are". First, Mr. Baudino provides no evidence for his assertion. Second, Mr. Baudino fails to acknowledge that use of a 0.90 beta is based on the strong evidence that investors have earned risk premiums on utility stocks over the period 1937 to 2017 that are approximately 90 percent of the risk premiums investors have earned on their investments in the S&P 500 over the same period.[199] According to the CAPM, a utility's beta should equal the ratio of the average risk premium on utility stocks to the average risk premium on the market portfolio. Dr. Vander Weide's evidence supports the conclusion that the ratio of the average risk premium on utility stocks to the average risk premium on the S&P 500 over the period 1937 to 2017 is 0.90, a number that is significantly higher than Mr. Baudino's recommended beta equal to 0.73.

Another significant error relates to Mr. Baudino argument that using a quarterly DCF model to estimate the cost of equity "overcompensates" investors because quarterly dividends are "already accounted for in a company's stock price since investors know that dividends are paid quarterly."[200] Dr. Vander Weide's position is that when dividends are paid quarterly, the stock price reflects the quarterly timing of the dividend payments, as Mr. Baudino himself acknowledges.[201] However, Mr. Baudino fails to recognize that quarterly dividends can only be reflected in a company's stock price if they are also reflected in the sequence of expected cash flows and the cost of equity. Contrary to Mr. Baudino's assertion, it is precisely because the value of quarterly dividends is reflected in a company's stock price that quarterly dividends must be used to estimate the investor's expected return on their investment in a company's stock.

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[198] Baudino Direct at 39-40.
[199] Vander Weide Direct at 41; *see also* Vander Weide Direct, Exhibit JVW-1, Schedule 7.
[200] Baudino Direct at 33.
[201] *Id.*

Intuitively, a company's cost of equity as measured by the DCF model reflects both the company's stock price and investors expected future amounts and timing of expected future cash flows. There must be congruence between the information. Because the companies in Dr. Vander Weide's comparable group all pay dividends quarterly, the current market price that investors are willing to pay reflects the expected quarterly receipt of dividends. Therefore, a quarterly DCF model should be used to estimate the cost of equity for these firms. The quarterly DCF model differs from the annual DCF model in that it expresses a company's price as the present value of a quarterly stream of dividend payments.[202]

Mr. Baudino's argument on this issue provides another example of his selective disclosure. Dr. Morin, Mr. Baudino's authority for some of his assertions, discredits Mr. Baudino's argument on this point:

> Clearly, given that dividends are paid quarterly and that the observed stock price reflects the quarterly nature of dividend payments, the market-required return must recognize quarterly compounding, for the investor receives dividend checks and reinvests the proceeds on a quarterly schedule ... The annual DCF model inherently understates the investors' true return because it assumes all cash flows received by investors are paid annually.[203]

Another factor in the development of Dr. Vander Weide's updated recommendation is the current trend in interest rates. Economists project that future interest rates will be higher than current interest rates as the Federal Reserve allows interest rates to rise in order to prevent inflation. Thus, the use of forecasted interest rates is consistent with the fair rate of return standard, whereas the use of current interest rates at this time is not.[204] If investors always expected forecasted interest rates to be equal to current interest rates, they would be unwilling to pay for economic forecasts from firms such as Consensus Economics, Blue Chip, and others.

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[202] Vander Weide Rebuttal at 17-18.
[203] Roger A. Morin, *New Regulatory Finance*, Public Utility Reports, Inc., 2006 at 344.
[204] Vander Weide Direct at 31.

The fact that numerous firms and individuals spend considerable sums to obtain forecasts of interest rates is sufficient evidence that they do not believe that current interests rates are the best forecast of future interest rates.[205]

In contrast to the current interest rate levels and expectations, Mr. Baudino has not made an adjustment to his recommended ROE of 8.80%. As he states in his testimony:

> "All the market evidence I examined fully supports my ROE recommendation for Atmos in this proceeding. As I described in Section II of my testimony, the U. S. economy is in a low interest rate environment, one that has been supported in a deliberate and considered fashion by Federal Reserve monetary policy. Both my DCF and CAPM ROE estimates show that the investor required ROE for Atmos, as well as other regulated gas and water utilities, reflect this low interest rate environment. An 8.80% ROE recommendation for Atmos is by no means too low in the current economic and financial environment."[206]

This is the same justification made by Mr. Baudino in the Columbia Gas Company rate proceeding two years ago.[207] However, at the hearing in the Duke Energy Kentucky Rate Case No: 2017-00321, in February 2018, Mr. Baudino agreed that interest rates are rising and are expected to continue to rise.[208] In response to questioning from Vice Chairman Cicero in this case hearing, Mr. Baudino agreed in this case that current increases in interest rates puts upward pressure on returns.[209] Yet, having acknowledged the change in interest rates and expected continued increases, he does not adjust his recommended return to reflect the realities of the current market. He admits that his recommended returns in recent cases have all been below 9.0, but that no allowed return in those cases has been near that number. He stated the Kentucky

[205] Vander Weide Rebuttal at 22.
[206] Baudino Direct at 29.
[207] *Application of Columbia Gas of Kentucky, Inc. for an Increase in Base Rates*, Direct Testimony of Richard Baudino at 29-30, Case No. 2016-00162 (Ky. PSC September 2, 2016).
[208] March 8, 2018, Video Transcript of Evidence at 9:31:09; *see also* March 8, 2018, Video Transcript of Evidence at 9:34:00.
[209] March 22, 2018, Video Transcript of Evidence at 4:09:00.

Power, LG&E and Kentucky Utilities ROE's were 9.7% and that he could cite no case that involved a return of below 9% in response to questioning from Vice Chairman Cicero.[210] However, Mr. Baudino recently acknowledged in the Duke case that rising interest rates justify higher ROEs.[211] He made the same admission in this case.[212] The conclusion from these comments is that current market conditions and rates necessitate higher returns. How Mr. Baudino can continue to recommend an 8.80% ROE given his acknowledgement of the effect of rising interest rates is unexplained and unwarranted.

In contrast to Mr. Baudino, Dr. Vander Weide's updated analysis confirms his updated recommendation of 10.6% ROE, using the most recent financial data.[213] He discounted reliance on RRA allowed returns discussed by Staff, because they only reflect regulatory commission decisions, not market forces.[214] He testified that market forces relevant to each particular case should be assessed to determine ROE, rather than solely relying on the RRA results.[215] Interestingly, Mr. Baudino agrees with Dr. Vander Weide on this point. Again, in the Duke rate case, Mr. Baudino says the RRA should not be the sole factor or even a weighted factor for determining ROE. Each case and each utility should be judged based on market conditions.[216] In addition, As Mr. Christian points out in his direct testimony, in the case of Atmos Energy, none of the Company's formula rate mechanisms are included in the average ROE outcomes reported by RRA even though the majority of the Company's capital investment is recovered through these mechanisms.[217] The reported RRA average return on equity thus has a significant

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[210] *Id.* at 4:08:09.
[211] March 8, 2018, Video Transcript of Evidence at TR 9:34:55.
[212] March 22, 2018, Video Transcript of Evidence at TR: 4:09:00.
[213] Atmos Energy's Response to Staff's PH-DR, Item 10. The Company's proposed revenue requirement in GKW-R-1 still reflects Dr. Vander Weide's initial recommendation of an ROE of 10.3%.
[214] March 22, 2018, Video Transcript of Evidence at 11:53:24.
[215] *Id.* at 11:54.
[216] March 8, 2018, Video Transcript of Evidence at 10:51.
[217] Christian Direct at 8.

omission in that it does not accurately reflect capital investment deployed through formula rate plans, and the ROE allowed on that investment, by only considering litigated outcomes.[218] The Company's allowed ROEs per its formula rate plans as provided in its latest 10-K are listed in the Company's response to Staff's Second Request, Item 28(b).

Finally, Dr. Vander Weide's cost of equity analysis reflects the financial risk of his proxy companies as measured by their average market value capital structure, which has more than 68 percent equity. If Atmos Energy's ratemaking, or book value capital structure, is used to set rates, the cost of equity for Atmos Energy will necessarily be higher than the cost of equity for the proxy group because the financial risk associated with Atmos Energy's book value capital structure is significantly higher than the financial risk reflected in the cost of equity estimate for the proxy companies. Atmos Energy is recommending a ratemaking capital structure containing 3.48 percent short-term debt, 43.95 percent long-term debt, and 52.57 percent common equity.[219]

In summary, Dr. Vander Weide has provided detailed, fully substantiated and sourced financial analysis to justify the recommended return on equity of 10.6%.

IX. ARM

The proposed ARM is designed to create a more efficient and lower cost process to review rates on an annual basis so that the rates paid by the customers more accurately reflect current costs. The Company is proposing the ARM to address the interests of customers, interveners and the Commission with a more efficient, cost-effective process, while at the same time better aligning the Company's costs and revenues. Specifically, the ARM would provide assurance to customers and the Company that the rates in place are appropriate and reflective of

[218] *Id.*
[219] Vander Weide Direct at 44-45.

the current cost of service. The ARM accomplishes this through annual, consistent and financially transparent rate reviews that ensure the Company earns no more than its authorized return while reducing the time and cost required in traditional ratemaking. This mechanism would replace the current process by which the Company files annual PRP filings in addition to periodic comprehensive rate cases. The ARM would provide an annual comprehensive review of the Company's overall financial performance instead of focusing on the limited issues relating to plant investments that the PRP entails. While the PRP has significantly streamlined recovery of the Company's investments in certain system integrity and safety related categories, it covers only approximately half of the Company's annual direct investment.

Furthermore, the PRP does not cover any of the investments made in assets that are shared by other jurisdictions and allocable to Kentucky. The PRP captures only return on and return of (depreciation expense) eligible investment plus an allowance for increased income taxes, ad valorem taxes and a minor adjustment for O&M savings. It does not adjust for changes in revenues (due to growth and declining usage), O&M, most taxes other than income taxes and changes in capital structure or cost of debt. Adjusting rates annually to reflect changes in all cost of service components would ensure that customers' rates best reflect the underlying actual costs incurred by the Company in delivering safe and reliable natural gas service.[220]

The ARM will provide benefits to customers by avoiding the costly and resource-intensive process to review adjustments through the traditional rate case process. The ARM will replace that process with a straightforward and financially transparent process that will ensure that the customer pays only the appropriate rate. The process will eliminate concerns regarding whether the Company's earnings are too high and mitigate the expensive and time consuming traditional rate making process. The OAG suggests that a fully forecasted test year should allow

[220] Direct Testimony of Mark Martin ("Martin Direct") at 21-22.

the Company the opportunity to earn its reasonable rate of return. In reality, the only way for the Company to avoid the regulatory lag that otherwise prevents it from earning its authorized return within the current regulatory construct would be to file annual general rate cases with fully forecasted test years. Such a plan would be costly in terms of rate case expenses primarily borne by customers as well as the resources of Commission Staff and other parties. For these reasons, the Company has proposed the ARM as a way to avoid the expense and resource constraints inherent in general cases.[221]

The ARM is fully transparent. It will provide for discovery, review and investigation by the Commission, OAG and other intervenors. Nothing in the ARM attempts to lessen the authority of regulators and intervening parties. In his rebuttal testimony, Mr. Waller explains the Company's proposed discovery procedures. He also states the Company's willingness to modify the ARM proposal to require a procedural schedule for each filing that includes a minimum of two rounds of discovery and opportunities for intervenor testimony and Company rebuttal testimony.[222] Because the ARM is designed to provide the information and support relevant and critical to calculating the cost of service, it is the Company's experience that such discovery and testimony is more focused and streamlined than that which is typically produced in general rate cases.

Second and perhaps most important, the Company will file financial schedules as more specifically identified in the proposed tariff attached to Mr. Waller's Direct testimony - Exhibit GKW-3 - that are consistent with the revenue requirement model the Company has used to calculate its revenue requirement in Kentucky dating back to at least 2009. The method of calculating each component of cost of service is also discussed in Exhibit GKW-3. The

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[221] Atmos Energy's Response to Commission Staff's Third Request for Information ("Staff's Third Request"), Item 7.
[222] Waller Rebuttal at 12-13.

methodologies detailed in the exhibit are consistent with the methodologies used in Atmos Energy's recent case filings approved by the Commission. Because the Company's proposal contemplates significantly fewer filing materials[223] there is less for Commission Staff to catalog and review. In the Company's experience in other states, this translates to fewer but more meaningful and direct discovery requests from intervenors which should translate into fewer hours spent by Staff reviewing unnecessary data. Furthermore, with each subsequent year, all stakeholders (Company, Staff, intervenors) get increasingly more efficient in preparing and reviewing the filing since it is filed in a consistent manner and with consistent ratemaking methodologies that eliminate the need for discovery and debate on issues that, as part of the ARM, are pre-determined.[224] A comparison of the current and Atmos Energy's proposed highlighted ARM filing requirements is shown in the table attached to this brief as Attachment 1.[225]

To address one of OAG witness. Kollen's objections, the Company agreed to change the relevant dates in its proposal to file its annual forward looking filing each June 1 for implementation on October 1 of each year, which will align the forward-looking test year with the Company's fiscal year. The resulting forward-looking test year would be October 1 - September 30. Doing so would allow the Company to file its fiscal capex budget without the need for the capex inflation factor that Mr. Kollen has criticized. If this proposed modification is adopted, the Company would plan to file its PRP filing as scheduled on August 1, 2018 (for PRP investment from October 1, 2018 - September 30, 2019). The first ARM filing would be June 1, 2019 and be for all investment (including PRP investment) for Fiscal 2020 (October 1, 2019 - September 30, 2020).[226]

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[223] Waller Direct at 8.
[224] Atmos Energy's response to Staff's Second Request, Item 13(f).
[225] *See also* Waller Direct, Exhibit GKW-3.
[226] Waller Rebuttal at 12-13.

The ARM is not a guaranteed rate of return. The Annual Reconciliation filing, as described in Exhibit GKW-3, reconciles each forward-looking test year to actual results and adjusts rates to ensure that the Company only earns its authorized rate of return. The practical reality is that the Commission ultimately determines the rates that the Company is authorized to charge. In any rate proceeding, whether through a traditional rate case or ARM, it is the responsibility of the Commission to establish rates and a level of return that only affords the Company the opportunity to earn a reasonable return on its invested capital.

Contrary to Mr. Kollen's generalized, unsupported objections of lack of consumer protections and Commission review, Atmos Energy cited references from the Tennessee and Mississippi utility regulatory agencies supporting the benefits of an alternative filing mechanism. For example, the Mississippi PSC 2015 Annual Report on page 8 states:

> "The Division periodically **examines financial records of the utilities to ensure that only allowable, necessary and prudently incurred expenses are included in rates**. It regularly monitors the earnings of the regulated companies to verify that these earnings fall within a reasonable range as determined by formulary rate plans approved by the Commission. The purpose of these plans is to provide performance incentives and a mechanism to annually evaluate the rates of each utility in relation to its cost of service and authorized earnings. **Use of the formulary rate plans has reduced the frequency of traditional rate cases and enabled the Staff to have an ongoing familiarity with the operations of the companies." (Emphasis added)**

Mr. Kollen's opposition to the ARM, which is based on his opinion that it provides no benefits to customers,[227] is so pervasive he believes that there is no formula ratemaking procedure that is appropriate.[228] Such unsupported, generalized opposition conflicts with the Commission's duty

[227] Kollen Direct at 68-69.
[228] March 22, 2018, Video Transcript of Evidence at 5:05:23.

to set fair, just and reasonable rates. KRS 278.030(1) limits the rates charged by a utility to those that are "fair, just and reasonable." KRS 278.190(1) requires the Commission upon the filing of proposed rates to determine a "reasonable rate." KRS 278.190(3) places the burden of proof to show the proposed rates are fair, just and reasonable on the applicant. These statutes place a duty on the Commission to ensure the rates are in the public interest. To suggest the Commission would no longer be bound by that limitation or that it would fail to follow it, is contrary to the practices and dedication of the Commissioners and Commission Staff. It also is undermined by the experience of the Tennessee Public Utility Commission, which allows a formulary mechanism like the one proposed in this case. Pursuant to TCA 65-5-101(a), the Tennessee Public Utility Commission has a duty to set fair, reasonable rates. "The Tennessee Public Utility Commission has the power after hearing upon notice, by order in writing, to fix just and reasonable individual rates…."[229] Because the ARM affords all parties the rights specified in the statutes, it cannot conflict with the public interest by depriving customers of the benefits of regulatory oversight.

Although Tennessee and Mississippi have ARM statutes, Kentucky has existing statutory authority to approve the proposed ARM under its plenary ratemaking authority derived from KRS 278.030 and KRS 278.040.[230] There should no longer be any concern about the Commission's authority to allow recovery of costs by a utility outside a general rate proceeding – a violation of the perceived "single issue ratemaking" prohibition. These concerns were put to rest by the Kentucky Supreme Court's opinion in *Duke, supra*.

Although the *Duke, supra* decision related to Duke's Accelerated Main Replacement Program Rider (AMRP), the Supreme Court's opinion addressed the broader issue of whether the Commission had the plenary authority to allow a utility to adjust its rates by imposing a surcharge

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[229] Tenn. Code Ann. § 65-5-101(a).
[230] *Kentucky Public Service Commission v. Commonwealth, ex rel, Conway and Duke Energy, Inc.*, et al, 324 S.W.3rd 373 (Ky. 2010).

or rider aimed at recovering costs <u>outside</u> a general rate proceeding. The Court held that so long as the rates established by the utility were fair, just and reasonable, the Commission has the broad ratemaking authority to allow recovery of costs outside the parameters of a general rate case – even in the absence of a statute specifically allowing such a mechanism.

The Kentucky Supreme Court accordingly rejected the Attorney General's argument that the Commission had no authority to permit a rider or surcharge to recover costs outside a general rate case (in the absence of a specific statute allowing it). In doing so, the Supreme Court concluded that: "…**the plain language of KRS 278.190 does not actually require the PSC to proceed with a general rate case or other particular process every time some new rate or change in rates is requested."**[231] (Emphasis added).

In short, there is no prohibition limiting the Commission's authority to set a rate or charge, except that it be fair, just and reasonable. Because a specific statute allows use of a future test year for the establishment of general rates - KRS 278.192 - it follows that any rate can also be determined using that methodology.

As the Court said in *Duke*:

> While the power to approve the AMRP rider at issue may not have been expressly granted by statute before the enactment of KRS 278.509, we, nonetheless, conclude **that the PSC has the power to allow such a rider based upon (1) its plenary ratemaking authority derived from KRS 278.030 and KRS 278.040, which essentially require that the PSC act to ensure that rates are "fair, just and reasonable" and (2) the absence of any statutes specifically requiring a particular procedure when determining if rates are fair, just, and reasonable.**[232] (Emphasis added).

The purpose of the annual mechanism is to provide the Company with a reasonable opportunity to recover costs and earn a fair and timely rate of return on significant incremental

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[231] *Duke,* supra, at 378.
[232] *Duke*, *supra*, at 380

capital investment. Based on the historical pattern of Atmos Energy's inability to earn its allowed return under current regulatory procedures, it is apparent that the current mix of rate case filings, tariffs and adjustment mechanisms are inadequate. Without a mechanism such as the one being suggested, Atmos Energy has no real opportunity to earn its reasonable rate of return. The proposed mechanism is merely a means to set a rate that is fair, just and reasonable consistent with the authority provided by KRS Chapter 278 and validated by the Court in the *Duke, supra*, case. Just as explained in that case, the ARM will have been approved in a general rate case, and only adjustments consistent with that approval will be reviewed in the ARM.[233]

Pursuant to KRS 278.030(1), "[e]very utility may demand, collect and receive fair, just and reasonable rates for the services rendered or to be rendered by it to any person." The Commission's discretion in determining what rates are "fair, just and reasonable," encompasses various considerations, calculations and methodologies to arrive at an end result. In *National Southwire Aluminum Co. v. Big Rivers Electric Corp.,* the Court said: "[The Commission] has many appropriate rate-making methodologies available to it, and it must have some discretion in choosing the best one for each situation. Again, we must look more to whether the result is fair, just and reasonable rather than at the particular methodology used to reach the result."[234] Also, in *Kentucky Indus. Utility Customers, Inc. v. Kentucky Utilities Company*, the Court said: "[T]he Commission has discretion in working out the balance of interest necessarily involved and that it is not the method, but the result, which must be reasonable."[235]

In a recent case, Kentucky American Water Company ("KAWC") filed an application for an annual tariff adjustment. The Commission rejected that filing based on the lack of inclusion of numerous filing requirements of 807 KAR 5:001(16). The Commission's order on rehearing said

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[233] *See id.*, fn. 17.
[234] *National Southwire Aluminum Co. v. Big Rivers Electric Corp.,* 785 S.W.2d 503, 516 (Ky. App. 1990)
[235] *Kentucky Indus. Utility Customers, Inc. v. Kentucky Utilities Company,* 983 S.W.2d 493, 498 (citing *Federal Power Comm'n v. Hope Natural Gas,* 320 U.S. 591, 64 (1944).

it was not rejecting the case based on the annual mechanism, but because of the sweeping deviation KAWC sought to limit the information included with the application. However, the Commission said that decisions on similar proposals will be based on the specific facts of each case.[236] This determination is consistent with the ruling in *Duke*:

> "To the extent that the PSC has established its own policy against 'single issue rate making', as suggested by the Attorney General's brief, it appears that the PSC would have discretion whether to retain or discard such a policy or determine whether it has been violated under the facts of a particular case given its plenary rate making authority circumscribed primarily by its duty to assure that rates are 'fair, just and reasonable' and the lack of clear statutory prohibition against 'single issue rate making'."[237]

Given this discretion to set ratemaking policy, there is no legal reason to reject Atmos Energy's ARM. Additionally, in contrast to the KAWC filing, Atmos Energy is proposing to provide all information related to calculating cost of service and any other information the Commission or intervenors request, which addresses the concern expressed in the KAWC case, *supra*.[238]

Based on the broad authority of the Commission to determine fair, reasonable rates, the annual mechanism proposed by Atmos Energy comports with that authority and allows for the review and establishment of rates using a streamlined procedure that benefits all parties.

X. ADIT-NOLC

The Company's test year rate base includes a reduction for a net accumulated deferred income tax ("ADIT") liability.[239] Embedded within the net ADIT liability balance is an ADIT asset (partially offsetting the liability balance) relating to a net operating loss carryforward

[236] *Electronic Application of Kentucky-American Water Company for a Qualified Infrastructure Program Rider*, Order at 9, Case No. 2017-00313 (Ky. PSC Sep. 27, 2017).
[237] *Duke, supra*, fn. 23.
[238] *See* Waller Direct at 9; *see also* Waller Rebuttal at 12-13.
[239] Waller Rebuttal, Exhibit GKW-R-1, Schedule B.5 F.

("NOLC").[240] The OAG's witness, Mr. Kollen, suggested eliminating this ADIT asset from the Company's rate base in his testimony, resulting in a proposed reduction of $3,741,762 from the Company's test period revenue requirement.[241] Alternatively, Mr. Kollen proposed a "Tracking Mechanism" while on the stand at the hearing in this proceeding that would track a decline in NOLC going forward but would not track changes in other elements of ADIT going forward.[242] Both of these recommendations are fundamentally flawed and, in fact, affirmatively dangerous to ratepayers and to the Company.

Removal of the NOLC-related ADIT asset as a component of the Company's net ADIT must be rejected for the following reasons:

1) The Company is obligated to follow the IRS' guidance as stated in Private Letter Ruling ("PLR") 201534001 ("Atmos Energy PLR"), issued by the National Office of the IRS in response to the Company's specific tax situation Kentucky.[243]
2) Removal of the NOLC asset from the Company's rate base is not appropriate under general ratemaking principles;[244]
3) Removal of the NOLC asset from the Company's rate base would cause a violation of the Internal Revenue Code's ("Code") normalization rules ("Normalization Rules"), thereby resulting in devastating tax consequences to the Company's customers and shareholders;[245] and,

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[240] *Id.*
[241] Kollen Direct at 18-30.
[242] March 22, 2018, Video Transcript of Evidence at 4:35.
[243] The Atmos Energy PLR was provided in the Rebuttal Testimony of Jennifer Story ("Story Rebuttal"), Exhibit JKS-R-1.
[244] Story Rebuttal at 11.
[245] *Id.* at 40.

4) Removal of the NOLC asset from the Company's rate base would be contrary to the Commission's prior ruling on this same issue in the Company's last litigated rate proceeding in Case No. 2013-00148.

The Tracking Mechanism must be rejected for the following reasons:

1) Like the removal of the NOLC-related ADIT asset from the Company's rate base, the Tracking Mechanism would cause a violation of the Normalization Rules, thereby resulting in the same devastating tax consequences to the Company's customers and shareholders;
2) The Tracking Proposal is predicated upon Mr. Kollen's flawed belief that the Company will no longer have an NOLC asset in three to five years;[246] and,
3) The Tracking Proposal improperly constitutes ratemaking based upon forecasting beyond the test period in this proceeding.

The parties agree on the fundamentals of ADIT. They agree that, when a tax deduction (such as accelerated depreciation) defers the necessity to pay income tax until a later year, then the Company is in possession of additional cash (*i.e.*, capital) it can invest in rate base. The existence of this additional capital is recorded on the Company's books as an ADIT liability, indicating that the Company will be required to pay the tax deferred at a future date. The ADIT liability balance is used to reduce rate base insofar as the capital it represents has zero cost. So the sole premise for reducing rate base is that the Company has the specified quantity of zero cost capital.

The parties also agree on the fundamentals of net operating losses ("NOLs"). An NOL is created in any year in which the Company's tax deductions exceed its taxable revenue. An NOL

[246] March 22, 2018, Video Transcript of Evidence at 4:33.

can be claimed as an additional deduction in the two prior years (carried back) or the subsequent twenty years (carried forward), in chronological order. The reason for this is that in the year the NOL was produced, some quantity of the Company's deductions did not reduce its tax liability. These deductions merely created the NOL. So claiming the NOL as a deduction in a prior or a subsequent year is akin to moving some of the Company's deductions from the year originally claimed on its tax return to the year in which the Company uses the NOL carryback or carryforward. In this case, we are dealing with NOLCs that, as of the end of the test year, have not been used.

An NOLC is, by definition, created by deductions that have not yet reduced the Company's tax liability in any year. It is self-evident, then, that such deductions cannot have deferred any tax and, hence, those deductions cannot have produced any zero-cost capital.

For accounting purposes, the Company records the tax effect of all its deductions as if they all defer tax. If the Company produces $100 of pre-tax book income before accelerated depreciation and claims $200 of accelerated depreciation, it will incur a $100 NOL. Its tax liability will be zero because it has sufficient accelerated depreciation deductions ($200) to offset all of its pre-tax income ($100). However, only $100 of its accelerated depreciation deductions actually defers tax. The rest is unused. Nevertheless, assuming a 21% income tax rate, the Company will record an ADIT liability of $42 – the deferral that would have transpired had there been enough taxable revenue to absorb all of the accelerated depreciation deductions. But that overstates the zero-cost capital in its possession. It will therefore also book a $21 offset, an ADIT asset, to memorialize that half the $42 of recorded tax deferral has not yet occurred. The proper amount by which to reduce rate base is $21 (the net of the $42 ADIT liability and the $21 ADIT asset) because that is all the zero-cost capital the Company possesses. This is the same methodology that was agreed to by the Commission and submitted to the IRS in connection with

the Atmos Energy PLR

Mr. Kollen asserts that customers are charged for $42 of deferred tax expense and are therefore entitled to the benefit of $42 of rate base offset. They are not. The way the Company accounts for such a situation, total tax expense would be $21. This consists of $0 current tax expense (the Company pays no taxes) and $21 of deferred tax expense (the amount of tax actually deferred). This $21 of deferred expense can be deconstructed into two components – a $42 deferred tax charge for the effect of the $200 of accelerated depreciation ($200 X 21%) and a $21 credit for the fact that $100 of those deductions simply created the NOL carryforward ($100 X 21%). Mr. Kollen asserts that the Company does not give customers the credit for the NOL carryforward and, therefore, charges them $42 in deferred tax expense. However, if that were the case, the Company would be charging customers for a tax rate of 42% ($42 of tax expense divided by $100 of pre-tax book income). That is not the case. In computing its $21 tax expense by applying the statutory tax rate (21%) to pre-tax book income ($100), the Company charges customers only $21 in deferred (and total) tax expense – not the $42 Mr. Kollen claims is the case. In short, the Company's methodology has embedded within it a $21 credit for the NOL carryforward.

Two things are worth noting. If, in the above example, instead of $200 of accelerated depreciation, the Company claimed $1,000,000 or $10,000,000 of accelerated depreciation, its zero cost capital would still be only $21. That is all the tax that could be deferred. And under the Company's method, that is the extent of its deferred tax charge. However, if Mr. Kollen's assertion regarding the charge levied on customers is correct, then there would be a $210,000 (in the case of $1,000,000 of accelerated depreciation) or a $2,100,000 (in the case of $10,000,000 of accelerated depreciation) deferred tax charge imposed on customers – even though pre-tax book income was only $100. That is not the Company's method for calculating tax expense for

its divisions. Nor, frankly, is it even a rational method. The Company demonstrated that its methodology for computing tax expense in this filing was to apply statutory tax rates to earnings on Company Hearing Exhibit No. 1. Mr. Kollen agreed with this calculation.[247] This contradicts his assertion in written testimony that tax expense is not reduced for the NOLC in the Company's filing.

Mr. Kollen seizes on PLR 201418024 (Mountaineer Gas PLR) as support for the proposition that, if the Company was to charge its customers $42 in deferred tax expense (or $210,000 or $2,100,000 in the larger examples), the normalization rules would not require that its NOL-related ADIT asset be included in rate base. That is, in fact, what the Mountaineer Gas PLR concludes. But that is only because the commission in that case claimed that the taxpayer's NOLC was paid for by its customers – that is, that the commission asserted that it imposed the same bizarre ratemaking Mr. Kollen erroneously asserts that the Company uses.[248] In the context of the example above, the taxpayer's regulators claimed that they would allow the taxpayer to charge its customers $42 in deferred tax expense. Thus, the taxpayer would be in possession of $42 of cost-free capital. $21 would come from the actual deferral of taxes and another $21 would come from charging customers for the taxes that the NOLC will defer at some point in the future. The IRS ruled that, if that were, in fact true, (though it did not find that it was true) the taxpayer would be in possession of $42 of cost-free capital and would not need to include the $21 NOL-related deferred tax asset as a reduction in its ADIT liability. But, unlike the utility in the Mountaineer Gas PLR, Atmos Energy never imposes a charge for deferred taxes that were not actually deferred.[249] Also, unlike the commission in the Mountaineer Gas PLR, this

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[247] March 22, 2018, Video Transcript of Evidence at 5:50.
[248] *See* Kollen Direct at 25. The PLR states, in pertinent part: "Commission has stated that, in setting rates it includes a provision for deferred taxes based on the entire difference between accelerated tax and regulatory depreciation, including situations in which a utility has an NOLC…. Such a provision allows a utility to collect amounts from ratepayers equal to income taxes that would have been due absent the NOLC…."
[249] Company Hearing Exhibit No. 1.

Commission has never asserted that the Company's NOLC is paid for by its customers.

Mr. Kollen is, therefore, incorrect about the potential applicability of the Mountaineer Gas PLR. The Company does not use the ratemaking described in that ruling. Further, his statement that the Company's request for the Atmos Energy PLR misstated its ratemaking methodology is wrong. The ratemaking described in the Atmos Energy PLR was entirely accurate. Prior to filing the Atmos Energy PLR request on January 9, 2015, the Company furnished a copy to the Commission for review. By letter dated December 15, 2014, the Commission indicated that it had reviewed the request and believed that the Statement of Facts was adequate and complete. Thus, the Atmos Energy PLR continues to govern the Company's situation in Kentucky. Per the Atmos Energy PLR:

> …the reduction of Taxpayer's rate base by the full amount of its ADIT account balance unreduced by the balance of its NOLC-related account balance would be inconsistent with (and hence violative of) the requirements of §168(i)(9) and §1.167(l)-1 of the Income Tax regulations.

And, as Ms. Story testified, the IRS reached the same conclusion it reached in the Atmos Energy PLR in at least another five PLRs issued around the same time.[250]

The Commission previously requested a "more definitive assessment of this issue," noting that "the NOLC issue may be at issue in future Atmos-Ky. Rate cases."[251] The Commission was quite prescient. The OAG has once again tried to confuse and mislead the Commission into ordering the Company to commit a normalization violation that would result in an overall increase in rate base and ultimately, a concomitant increase in the rates charged to the Company's customers. Fortunately, the Commission took steps in its Order in Case No. 2013-00148 to ensure that should the issue arise again, there would be a definitive answer. The Atmos

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[250] Story Rebuttal at 35.
[251] *Application of Atmos Energy Corporation for an Adjustment of Rates and Tariff Modifications*, Order at 7, Case No. 2013-00148 (Ky. PSC Apr. 22, 2014).

Energy PLR issued after the 2013-00148 Order is inarguably the definitive assessment of this issue. The Company and the Commission both reviewed the facts provided at the time the Atmos Energy PLR was sought and concurred that they were accurately presented to the IRS. The OAG, which did not avail itself of its opportunity to provide comments to the IRS in the Atmos Energy PLR process, now comes and retroactively challenges the IRS' determination, despite having no new facts or evidence and even though none of the facts or circumstances surrounding this issue have changed. The Commission must affirm its prior ruling on this issue.

Alternatively, Mr. Kollen proposes to establish a rider to track the use of the NOL carryforward. This, too, creates a problem with the Normalization Rules. Public utilities are entitled to claim accelerated methods of depreciation with respect to their assets only if they utilize a "normalization method of accounting." Code §168(f)(2). Where such a method is not used, a utility may only claim regulatory depreciation for tax purposes. The Normalization Rules prohibit the direct flowing through of the tax benefits of accelerated depreciation. Code §168(i)(9)(A) and Treas. Reg. §1.167(l)-1(h)(1)(i)(b) require the utility (1) to compute its tax expense for ratemaking purposes using ordinary non-accelerated depreciation, and (2) to make adjustments to a reserve to reflect the deferral of taxes resulting from the additional depreciation (*i.e.,* it must credit an ADIT account, which may be subtracted from rate base). In this manner, the Normalization Rules provide for the mandatory recognition of deferred taxes and preclude direct flow-through of the benefit of accelerated depreciation to customers. Those rules do, however, permit utilities to provide customers the zero-cost benefit produced by claiming accelerated depreciation.

Mr. Kollen's proposed rider specifically creates a problem with the aspect of the Normalization Rules referred to as the Consistency Rule. The Consistency Rule provides:

(i) In general. One way in which the requirements of subparagraph (A) are not met

is[252] *if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with the requirements of subparagraph (A).*

(ii) Use of inconsistent estimates and projections. The procedures and adjustments which are to be treated as inconsistent for purposes of clause (i) shall include any procedure or adjustment for ratemaking purposes which uses an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under subparagraph (A)(ii) unless such estimate or projection is also used, for ratemaking purposes, with respect to the other 2 such items and with respect to the rate base.

This statute requires that the same regulatory procedures be applied to deferred taxes, tax expense, depreciation expense and rate base. It recognizes that some of the benefit of accelerated depreciation can be inappropriately extracted by manipulating the amount of ADIT that is treated as zero-cost capital by "mixing and matching" regulatory procedures.

Mr. Kollen emphasized his familiarity with the Consistency Rule and testified that this rule is found in tax regulations.[253] That is incorrect. It is, in fact, contained in a statutory provision – Code § 168(i)(9)(B). Moreover, since the enactment of this statutory provision in 1982, no regulations have been issued that pertain to it. The regulations to which Mr. Kollen refers in his testimony do not directly relate to the Consistency Rule. It is therefore not surprising that he erroneously concluded that his proposed tracking mechanism would not violate the Consistency Rule.

Mr. Kollen's proposed NOLC tracker is a perfect example of prohibited "mixing and matching." The proposed tracker applies solely to take account of NOLC utilization – an event that can only increase ADIT (and thereby decrease rate base). It would not apply to the reversals of existing deferred taxes, which would decrease ADIT (and thereby increase rate base). Nor would it apply to increases in net plant, events that would also increase rate base. In short, Mr. Kollen proposes to apply a regulatory procedure – a tracker – to only a single aspect of ADIT,

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[252] That is a taxpayer does not use a normalization method of accounting.
[253] March 22, 2018, Video Transcript of Evidence at 3:35.

NOLC utilization, because it decreases rate base. All of the other aspects of rate base, including the other aspects of ADIT and net plant, would remain and be subject to the "normal" ratemaking process. They would not be considered until the Company's next base rate case. The obvious intent of the selectivity of the application of the tracker is to maximize ADIT and minimize rate base. That is precisely what the Consistency Rule was intended to prevent.

On the stand at the hearing on March 22, 2018, Mr. Kollen suggested a Tracking Mechanism that would reflect any future downward reductions in the Company's NOLC by lowering the Company's rate base, without any regard to future changes in ADIT.[254] One of the underpinnings of this proposal was Mr. Kollen's suggestion that the Company will be able to use up its NOLC in the near future, "we're virtually certain that it's going to decline to zero over the next three to five years."[255] This conclusion is purely speculative and should not be the basis for an adjustment. In arriving at his conclusion, Mr. Kollen neglected to account for other depreciation items the Company anticipates over the next few years such that the NOLC will not be all used up in 3-5 years.

A further error in Mr. Kollen's "Tracking Mechanism" is his suggestion that the amortization of excess ADIT associated with NOLC resulting from the recent federal income tax reform need not be netted against excess ADIT refunded to ratepayers.[256] This suggestion is contrary to proper ratemaking principles and would result in a return of amounts in excess of tax the Company actually deferred. As described previously, inclusion of both the ADIT liabilities and the NOLC in rate base reflects the true zero-cost capital that the Company has received. This is the tax liability that was deferred to the future. The reduction in the tax rate from tax reform resulted in a reduced tax deferral since the Company's future tax liabilities will be lower.

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[254] March 22, 2018, Video Transcript of Evidence at 4:34.
[255] *Id.* at 4:35.
[256] *Id.* at 4:37.

Therefore, the Company must return to customers that portion of zero-cost capital, or actual taxes deferred, that will no longer be due to the government in the future. The net excess ADIT, including both ADIT liabilities and excess ADIT relating to the NOLC reflects the excess of cost-free capital (deferred taxes) resulting from the tax rate reduction. This is the only appropriate amount to return to customers. Mr. Kollen's proposal to only amortize the excess ADIT resulting from deductions would result in a refund of amounts not reflective of cost-free capital (deferred taxes) the Company actually received. It would be just as inappropriate for the Company to suggest that it only flow back the excess ADIT associated with NOLC and not flow back any of the other excess ADIT.[257]

Mr. Kollen's alternative suggestion to include amortization of the excess ADIT associated with the NOLC in a "Tracking Mechanism" would violate the normalization provisions. Excess ADIT associated with the NOLC is protected by the normalization requirements since the underlying ADIT NOLC amount is protected. The Atmos Energy PLR is unambiguous about this fact. The use of an amortization period unsupported by the ARAM or Reverse South Georgia calculation would not comply with the Tax Cuts and Jobs Act and the normalization provisions.[258] Mr. Kollen's proposed "Tracking Mechanism" would certainly result in such an inappropriate amortization period and would result in a normalization violation.

Putting aside the normalization problems with Mr. Kollen's "Tracking Mechanism," there is another fundamental problem with it. The Tracking Proposal improperly constitutes ratemaking via forecasting beyond the test period in this proceeding. If this Commission wished to adjust the Company's NOLC on an annual basis going forward, it must also consider changes in ADIT and all other elements of the cost of service.

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[257] The Company's ARM as proposed in this proceeding would constitute a better way of capturing changes in NOLC and ADIT on an annual basis and it would not result in a normalization violation.
[258] Story Rebuttal at 47.

If either of Mr. Kollen's proposals – to ignore the NOL-related ADIT asset in the computation of rate base or to impose his Tracking Mechanism on the Company's NOLC utilization – is adopted by the Commission, Atmos would be subject to the penalties attendant to violating the Normalization Rules. Under these rules, Atmos Energy would be disqualified from claiming accelerated depreciation in the future, allowing only regulatory depreciation for tax purposes.[259] If that were to occur, the Company would, in the future, create no more depreciation-related deferred taxes. Moreover, its existing balance of ADIT would diminish as the underlying timing differences reverse. This inability to generate additional cost-free capital in conjunction with the depletion of the Company's existing stock of cost-free capital would have a serious and long-term detrimental impact on ratepayers.

XI. CLASS COST OF SERVICE

Atmos Energy proposed rates to be implemented based on a fully allocated cost of service study prepared by Paul Raab a consulting economist with extensive experience. It is a generally accepted utility ratemaking principle that rates should be based on costs, not only the overall level of costs incurred by the utility, but also the costs that the utility incurs to serve individual services, classes of customers, and segments of the utility's business. Adherence to this principle is complicated by the fact that many of the costs incurred to provide different types of service are "joint" costs and many are "common" costs, neither of which has a theoretically precise method by which they can be assigned to the different products produced as a result of the incurrence of these costs.[260] Thus, class cost of service studies are the primary method used to allocate the common and joint costs incurred by the utility in serving different customer classes. They are used

[259] Story Rebuttal at 40, citing Treas. Reg. 1.167(1)-1(h)(5).
[260] Direct Testimony of Paul Raab ("Raab Direct") at 7.

for five purposes:

1. To attribute costs to different categories of customers based on how those customers cause costs to be incurred;

2. To determine how costs will be recovered from customers within each customer class;

3. To calculate the costs of individual types of service based on the costs each service requires the utility to expend;

4. To determine the revenue requirement for the monopoly services offered by a utility operating in both monopoly and competitive markets; and

5. To separate costs between different regulatory jurisdictions.[261]

The development of multiple COSS studies in this case is in direct response to Commission directives in its order in Case No. 2013-00148. The primary directive from that order is that, "the Commission strongly encourages Atmos-Ky. to file multiple-methodology COSSes in future rate cases in order to give the Commission a range of reasonable results for use in determining revenue allocation and rate design."[262] In addition, the Commission also stated that, "With this Order, the Commission puts all parties to future rate proceedings on notice that we cannot give full consideration to a COSS that does not show separately each of the typical individual COSS steps of functionalization, classification, and allocation."[263]

As recognized by the Commission in its Order in Case No. 2013-00148, the treatment of distribution mains in the COSS has a significant impact on the class results: "Although certain minor differences exist between the two COSSes, [Atmos Energy] and the AG agree that the

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[261] *Id.* at 8.
[262] *Application of Atmos Energy Corporation for an Adjustment of Rates and Tariff Modifications*, Order at 34, Case No. 2013-00148 (Ky. PSC Apr. 22, 2014).
[263] *Id.* at 35; *see also* Raab Direct at 3.

primary difference lies in the treatment of distribution mains."[264] As a result, Mr. Raab developed three COSS studies for this case that differ based on the treatment of distribution mains. This presentation is also consistent with the Company's presentation in its last base rate proceeding, Case No. 2015-00343.[265]

The first study, termed the "customer/demand" study, classifies investments in distribution mains as both customer- and demand-related using the "minimum system" approach. Such a classification reflects the fact that the Company's level of investment in distribution mains is driven by the maximum demand that customers place on the system, but that there is also a minimum level of investments in distribution mains that would be necessary regardless of the level of such demands.[266] A second COSS study, termed the "demand-only" study, classifies investments in distribution mains as only demand-related. The third study, entitled the "demand/commodity" study, reflects the Commission's 1987 guidance that, "cost-of-service methodologies should give some consideration to volume of use."[267] While Mr. Raab disagrees that such an approach reflects distribution mains investment cost incurrence, and therefore is a results-driven choice of classification methodologies, the study has been prepared for the Commission's consideration.[268] These three studies are filed in this case as Exhibits PHR-2, PHR-3 and PHR-4, respectively, the Direct Testimony of Paul H. Raab.

The summary results of Mr. Raab's allocation studies are provided on lines 34 and 35 of the first page of each class cost of service study and on Exhibit PHR-5. Page 1 of Exhibit PHR-5 shows actual and relative returns at present rates, the increases needed for an equalized proposed

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[264] *Application of Atmos Energy Corporation for an Adjustment of Rates and Tariff Modifications*, Order at 32, Case No. 2013-00148 (Ky. PSC Apr. 22, 2014).
[265] Raab Direct at 4.
[266] *Id.*
[267] *An Investigation of the Impact of Federal Policy on Natural Gas to Kentucky Consumers and Suppliers* ("Admin. 297") Order at 47, Administrative Case No. 297 (Ky. PSC May 29, 1987).
[268] Raab Direct at 5.

return by class and the estimated customer-related costs for the Company and for each of the cost of service classes for each of the studies developed. Exhibit PHR-5 identifies for the Commission the extent to which rates need to be adjusted so that all identified subsidies can be eliminated under a range of reasonable allocation assumptions. While this exhibit shows that all classes are making positive contributions to rate of return, the residential class is generally providing less than the system average rate of return. All other classes are generally providing a return greater than the system average return, as indicated by at least one of the alternative allocation schemes.[269]

Based on the revenue increase allocation advocated by Company witness Mark Martin, the rate classes move closer to an equalized rate of return. This can be seen by comparing the class relative rates of return at proposed rates (line 56 of page 1 of Exhibits PHR-2, PHR-3 and PHR-4) to the class relative rates of return at existing rates (line 35 of page 1 of those same exhibits). If the class relative rates of return at proposed rates move closer to 1.0, the proposed revenue increase is a movement toward parity of class returns and a reduction of interclass subsidies. As this condition prevails across all classes and studies, Mr. Raab concludes that the Company's proposed revenue distribution is a reasonable movement toward reducing interclass subsidies. The Company's proposals therefore appear to be reasonable and reflect gradualism in the assignment of the revenue increase.[270]

Finally, Mr. Martin proposed customer charges for Residential Sales Customers of $20.50/month and $52.50/month for Non-Residential Sales Customers in the original filing. The levels of these charges are generally within the bounds established by the different studies, as shown on lines 8 and 9 of Page 2 of Exhibit PHR-5 of Mr. Raab's testimony.

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[269] *Id.* at 20.
[270] *Id.* at 21.

XII. R&D RIDER

The Company's current R&D unit charge is $0.0035 per Mcf. The Company proposed and the Commission approved the Company's R&D Rider in Case No. 99-070. The R&D unit charge applies to all customers except transportation customers. Prior to Case No. 99-070, interstate pipelines charged local distribution companies (LDCs) an R&D surcharge which ultimately flowed through the Gas Cost Adjustment (GCA) mechanism. The interstate pipelines began to phase out the surcharge with 2004 being the last year that R&D charges flowed through the GCA mechanism. To maintain the same level of funding, the Company planned to raise its R&D unit charge a corresponding amount on an annual basis to offset the reduction in pipeline charges. By 2004, the Company's R&D charge should have equaled $0.0174 per Mcf, which would have mirrored the interstate pipeline rate prior to the phase-out.

While the Company has never increased its R&D unit charge, it did implement the appropriate rate at inception. Since that time, the Company has inadvertently failed to increase its R&D unit charge. The Company proposes to correct that oversight and increase the R&D unit charge to $0.0174 per Mcf.

With the current R&D unit charge of $0.0035 per Mcf and assuming sixteen (16) Bcf of annual sales, applicable customers collectively contribute approximately $56,000 for R&D efforts. Increasing the R&D unit charge to $0.0174 per Mcf would increase funding by approximately $222,000 for a total annual contribution of approximately $278,000 ($56,000 + $222,000). The proposed increase in funding will only increase the average residential customer's bill by approximately $0.07 per month. Also, the proposed total annual contribution of $278,000 would be less than the Commission approved for Columbia Gas of Kentucky, which also collects for research and development initiatives.

The Company as well as its customers benefit by new technology and more efficient

appliances that result from research funded by the R&D Rider. All funds collected under the R&D Rider are remitted to the Gas Technology Institute (GTI), or a similar research organization. All funds collected through the R&D unit charge have been remitted to GTI, which even Mr. Kollen agrees is a first-rate research facility for gas services.[271]

Mr. Martin discusses the benefits of the R&D contribution in his Rebuttal Testimony, pp. 11-12. He also provides a list of currently funded GTI research projects funded through the Atmos Energy contribution. Examples are "Remote Gas Sensing and Monitoring" equipment; "Leak Detection and Repair for Distribution Systems"; "Steel Pipeline Material Traceability" and "Cybersecurity."[272] All of these research projects are directed at the improvement of safety, operational practices, increased efficiency of appliances and improvement of materials and equipment. It is impossible to determine a precise cost savings to either the company or ratepayers. However, the intangible benefits resulting from the improvement of safety, leak detection equipment, improved materials and similar developments provides indirect benefits to everyone. Atmos Energy's proposed fee is relatively modest, being below the $300,000 annual GTI commitment approved for Columbia Gas of Kentucky[273] and Sheet No. 51c of Columbia Gas of Kentucky's tariff.

XIII. CONCLUSION

Atmos Energy is one of the most efficient, well managed utilities in Kentucky. It has the lowest rates, an excellent safety record and a commendable working relationship with the Commission. There were no consumer interveners in this case, no customers appeared at the public meeting in Owensboro and no customers appeared at the hearing to protest the rate

[271] March 22, 2018, Video Transcript of Evidence at 3:17:30.
[272] Atmos Energy's response to Staff's Second Request, Item 11.
[273] March 22, 2018, Video Transcript of Evidence at 11:10:30.

adjustment. The Company has maintained its system and engaged in an extensive pipeline replacement program, while keeping rates below those of other gas utilities. It has continued to provide the highest level of service to the public without rate spikes or diminution of performance standards. Its efforts to maintain its high level of performance and service to its customers is reflected in this case. To continue this level of regulated activity, there should be recognition of the Company's efforts through approval of its rates and tariff proposals.

The Company filed its application for an adjustment of rates pursuant to the Commission's regulations and in conformity with prior rate applications. In addition to the proposed increase in annual revenue, the Company proposed several tariff modifications: Update the R&D rider; Update the time period to weather normalized revenues under the Company's weather normalization adjustment ("WNA") rider; and implement an Annual Rate Mechanism ("ARM"). The current Pipeline Replacement Program tariff was also reviewed. These issues present an opportunity for the Commission to decisively resolve outstanding matters that have been litigated and re-litigated over several rate filings.

Approval of the ARM, which Atmos Energy has referenced in prior cases, will resolve the legal and regulatory questions about the proposed tariff and will allow for the implementation of a streamlined annual review of the Company's operations.

Continuation of the PRP's current projects and proposed funding levels will allow the Company to continue the accelerated replacement of aging infrastructure in order to maintain a safe and reliable system, as well as avoiding future issues about the scope and timing of the program. The ongoing annual review of the projects and funding will continue as part of the tariff filing requirements, but there will be no need for review of those same issues in the rate case.

Another significant opportunity for the Commission to assert finality to an issue is with

NOLC. This issue has been litigated in the last three cases. Atmos Energy has obtained a decisive, final ruling from the Internal Revenue Service through the Atmos Energy PLR that its treatment of NOLC is correct. In spite of this ruling, the OAG continues to litigate the issue without any legal or factual basis. A Commission ruling that the Atmos Energy PLR is binding will eliminate another time-consuming challenge to the IRS directive.

Approval of the updated rate for the R&D rider will confirm the reasonableness of the charge for natural gas research and development and preclude future questions about its validity as a regulatory expense, as well as conform the Company's R&D rider to those of comparable utilities within the Commonwealth.

The Company has presented extensive expert testimony to support its proposed revenue and tariff adjustments. While the OAG's experts have questioned the Company's proposals, for the most part they have relied on opinion, disagreement over policy and unsubstantiated objections – none of which reach the level of substantial evidence.

For these reasons, Atmos Energy requests that the Commission approve the requested adjustments to rates and tariffs.

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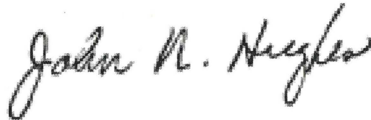

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Attorneys for Atmos Energy Corporation

Section 16(1)(b)

1. A statement of the reason the adjustment is required.

2. A certified copy of a certificate of assumed name as required by KRS 365.015 or a statement that such a certificate is not necessary.

3. New or revised tariff sheets, if applicable, in form complying with 807 KAR 5:011 with an effective date not less than thirty (30) days from the date the application is filed.

4. New or revised tariff sheets, if applicable, shown either by providing the present and proposed tariffs in comparative form on the same sheet side by side or on facing sheets side by side, or providing a copy of the present tariff indicating proposed additions by italicized inserts or underscoring and striking over proposed deletions.

5. Statement that notice has been given in compliance with Section 17 of this administrative regulation, with a copy of the notice.

6. If a water district proposes to increase any current rate for service or implement a new rate for service, a statement from an authorized official of the district indicating the date the proposed rate increase or new rate was reported to the governing body of the county in which the largest number of its customers resides and the date it presented testimony, or is scheduled to present testimony, to that governing body.

Section 16(2)

If gross annual revenues exceed $5,000,000, was written notice of intent to file a rate application filed at least thirty (30) days, but not more than sixty (60) days prior to application?

(a) Notice shall state whether the application will be supported by historical or a fully forecasted test period.

(c) Has a copy of the notice of intent been served upon the Attorney General, either by electronic mail in a portable document format or mail?

Section 16(6)

(a) Financial data for forecasted period presented as pro forma adjustments to base period.

(b) Forecasted adjustments shall be limited to the 12 months immediately following the suspension period.

(c) Capitalization and net investment rate base shall be based on a 13 month average for the forecasted period.

(f) Reconciliation of the rate base and capital used to determine its revenue requirements.

Section 16(7)

(a) Written testimony of each witness supporting its application including testimony from chief officer in charge of Kentucky operations on the existing programs to achieve improvements in efficiency and productivity, including an explanation of the purpose of the program; IF REQUESTED

(b) Most recent capital construction budget containing at minimum a 3 year forecast of construction expenditures;

(c) Complete description, which may be in written testimony form, of all factors used to prepare forecast period. All econometric models, variables, assumptions, escalation factors, contingency provisions, and changes in activity levels shall be quantified, explained, and properly supported;

(d) Annual and monthly budget for the 12 months preceding filing date, base period and forecasted period;

(e) Attestation signed by utility's chief officer in charge of Kentucky operations providing:

1. That forecast is reasonable, reliable, made in good faith and that all basic assumptions used have been identified and justified; and

2. That forecast contains same assumptions and methodologies used in forecast prepared for use by management, or an identification and explanation for any differences; and

3. That productivity and efficiency gains are included in the forecast;

(f) For each major construction project constituting 5% or more of annual construction budget within 3 year forecast, following information shall be filed:

1. Date project began or estimated starting date;

2. Estimated completion date;

3. Total estimated cost of construction by year exclusive and inclusive of Allowance for Funds Used During Construction ("AFUDC") or Interest During Construction Credit; and

4. Most recent available total costs incurred exclusive and inclusive of AFUDC or Interest During Construction Credit;

(g) For all construction projects constituting less than 5% of annual construction budget within 3 year forecast, file aggregate of information requested in paragraph (f) 3 and 4 of this subsection;

(h) Financial forecast for each of 3 forecasted years included in capital construction budget supported by underlying assumptions made in projecting results of operations and including the following information:

1. Operating income statement (exclusive of dividends per share or earnings per share);

2. Balance sheet;

Statement of cash flows;

Revenue requirements necessary to support the forecasted rate of return;

Load forecast including energy and demand (electric);

Access line forecast (telephone);

Mix of generation (electric);

Mix of gas supply (gas);

Employee level;

. Labor cost changes;

. Capital structure requirements;

. Rate base;

. Gallons of water projected to be sold (water);

. Customer forecast (gas, water);

. Sales volume forecasts – cubic feet (gas);

. Toll and access forecast of number of calls and number of minutes (telephone); and

. A detailed explanation of any other information provided

(i) Most recent FERC or FCC audit reports;
(j) Prospectuses of most recent stock or bond offerings;

(k) Most recent FERC Form 1 (electric), FERC Form 2 (gas), or and PSC Form T (telephone);

(l) Annual report to shareholders or members and statistical supplements covering the most recent 2 years from the application filing date;

(m) Current chart of accounts if more detailed than Uniform System of Accounts chart;

(n) Latest 12 months of the monthly managerial reports providing financial results of operations in comparison to forecast;

(o) Complete monthly budget variance reports, with narrative explanations, for the 12 months immediately prior to base period, each month of base period, and subsequent months, as available;

(p) SEC's annual report (Form 10-K) for most recent 2 years, any Form 8-Ks issued during past 2 years, and any Form 10-Qs issued during past 6 quarters;

(q) Independent auditor's annual opinion report, with any written communication from auditor which indicates the existence of a material weakness in internal controls;

(r) Quarterly reports to the stockholders for the most recent 5 quarters;

(s) Summary of latest depreciation study with schedules

itemized by major plant accounts, except that telecommunications utilities adopting Commission's average depreciation rates shall identify current and base period depreciation rates used by major plant accounts. If information has been filed in another commission case, refer to that case's number;

(t) List all commercial or in-house computer software, programs, and models used to develop schedules and work papers associated with application. Include each software, program, or model; its use; identify the supplier of each; briefly describe software, program, or model; specifications for computer hardware and operating system required to run program;

(u) If the utility had any amounts charged or allocated to it by an affiliate or general or home office or paid any monies to an affiliate or general or home office during the base period or during the previous three (3) calendar years, the utility shall file:

1. Detailed description of method of calculation and amounts allocated or charged to utility by affiliate or general or home office for each allocation or payment;

2. Method and amounts allocated during base period and method and estimated amounts to be allocated during forecasted test period;

3. Explain how allocator for both base and forecasted test period was determined; and

4. All facts relied upon, including other regulatory approval, to demonstrate that each amount charged, allocated or paid during base period is reasonable;

(v) If gas, electric, sewage or water utility, whose annual gross revenues exceed $5,000,000 in the division for which a rate adjustment is sought, a cost of service study based on methodology generally accepted in industry and based on current and reliable data from single time period;

(w) Local exchange carriers with fewer than 50,000 access lines need not file cost of service studies, except as specifically directed by PSC. Local exchange carriers with more than 50,000 access lines shall file:

1. Jurisdictional separations study consistent with 47 C.F.R. Part 36 of the FCC's rules and regulations; and

2. Service specific cost studies supporting pricing of services that generate annual revenue greater than $1,000,000 except local exchange access:

a. Based on current and reliable data from single time period; and

b. Using generally recognized fully allocated, embedded, or incremental cost principles.

Section 16(8)

(a) Jurisdictional financial summary for both base and forecasted periods detailing how utility derived amount of requested revenue increase;

(b) Jurisdictional rate base summary for both base and forecasted periods with supporting schedules which include detailed analyses of each component of the rate base;

(c) Jurisdictional operating income summary for both base and forecasted periods with supporting schedules which provide breakdowns by major account group and by individual account;

(d) Summary of jurisdictional adjustments to operating income by major account with supporting schedules for individual adjustments and jurisdictional factors;

(e) Jurisdictional federal and state income tax summary for both base and forecasted periods with all supporting schedules of the various components of jurisdictional income taxes;

(f) Summary schedules for both base and forecasted periods (utility may also provide summary segregating items it proposes to recover in rates) of organization membership dues;

initiation fees; expenditures for country club; charitable contributions; marketing, sales, and advertising; professional services; civic and political activities; employee parties and outings; employee gifts; and rate cases;

(g) Analyses of payroll costs including schedules for wages and salaries, employees benefits, payroll taxes straight time and overtime hours, and executive compensation by title;

(h) Computation of gross revenue conversion factor for forecasted period;

(i) Comparative income statements (exclusive of dividends per share or earnings per share), revenue statistics and sales statistics for 5 calendar years prior to application filing date, base period, forecasted period, and 2 calendar years beyond forecast period;

(j) Cost of capital summary for both base and forecasted periods with supporting schedules providing details on each component of the capital structure;

(k) Comparative financial data and earnings measures for the 10 most recent calendar years, base period, and forecast period;

(l) Narrative description and explanation of all proposed tariff changes;

(m) Revenue summary for both base and forecasted periods with supporting schedules which provide detailed billing analyses for all customer classes; and

(n) Typical bill comparison under present and proposed rates for all customer classes.

Section 17(4)

(a) The proposed effective date and the date the proposed rates are expected to be filed with the commission

(b) The present and proposed rates for each customer class to which the proposed rates will apply.

(c) Amount of change requested in dollar amounts and percentage change for each customer classification to which change will apply.

(d) Electric, gas, water and sewer utilities - the amount of the average usage and the effect upon average bill for each customer class to which change will apply.

(d) Local exchange companies - include effect upon average bill for each customer class for change in basic local service.

Section 17(4) If copy of public notice included, did it meet requirements?*

Section 17 Notice

If a utility has twenty (20) or fewer customers or is a sewage utility, the utility shall mail a written notice to each customer no later than the date on which the application is submitted to the commission.

If a utility has more than twenty (20) customers and is not a sewage utility, it shall provide notice by:

1. Including notice with customer bills mailed no later than the date the application is submitted to the commission;

2. Mailing a written notice to each customer no later than the date the application is submitted to the commission;

3. Publishing notice once a week for three (3) consecutive weeks in a prominent manner in a newspaper of general circulation in the utility's service area, the first publication to be made no later than the date the application is submitted to the commission; or

4. Publishing notice in a trade publication or newsletter delivered to all customers no later than the date the application is submitted to the commission.

A utility that provides service in more than one county and is not a sewage utility may use a combination of the notice methods.

Each notice shall contain:

(1) The proposed effective date and the date the proposed rates are expected to be filed with the commission;

(2) The present rates and proposed rates for each customer classification to which the proposed rates will apply;

(3) The amount of the change requested in both dollar amounts and percentage change for each customer classification to which the proposed rates will apply;

(4) The amount of the average usage and the effect upon the average bill for each customer classification to which the proposed rates will apply, except for local exchange companies, which shall include the effect upon the average bill for each customer classification for the proposed rate change in basic local service;

(5) A statement that a person may examine this application at the offices of (utility name) located at (utility address);

(6) A statement that a person may examine this application at the commission's offices located at 211 Sower Boulevard, Frankfort, Kentucky, Monday through Friday, 8:00 a.m. to 4:30 p.m., or through the commission's Web site at *http://psc.ky.gov*;

(7) A statement that comments regarding the application may be submitted to the Public Service Commission through its Web site or by mail to Public Service Commission, Post Office Box 615, Frankfort, Kentucky 40602;

(8) A statement that the rates contained in this notice are the rates proposed by (utility name) but that the Public Service Commission may order rates to be charged that differ from the proposed rates contained in this notice;

(9) A statement that a person may submit a timely written request for intervention to the Public Service Commission, Post Office Box 615, Frankfort, Kentucky 40602, establishing the grounds for the request including the status and interest of the party; and

(10) A statement that if the commission does not receive a written request for intervention within thirty (30) days of initial publication or mailing of the notice, the commission may take final action on the application.

(Waller Direct Exhibit GKW-3)