COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In The Matter of:

ELECTRONIC APPLICATION OF ATMOS	)	
ENERGY CORPORATION FOR AN ADJUSTMENT	)	Case No.
OF RATES	)	2018-00281

ATTORNEY GENERAL's POST-HEARING BRIEF

Respectfully submitted,

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Comes now the intervenor, the Attorney General of the Commonwealth of Kentucky ("the Attorney General"), by and through his Office of Rate Intervention, and tenders the following post-hearing brief in the above-styled matter.

I. STATEMENT OF THE CASE

On September 28, 2018 Atmos Energy Corporation ("Atmos" or "the Company") filed its application in the above-styled action, in which it sought, *inter alia*, permission to increase its base rate revenues by approximately $14.455 million, and to implement new depreciation rates developed through the Equal Life Group ("ELG") procedure.[1] Following the curing of deficiencies, the Commission accepted the application for filing on October 9, 2018. The Attorney General's motion to intervene was granted on October 26, 2018. No other parties sought intervention. Commission Staff posed five rounds of data requests to Atmos, and the Attorney General posed two rounds.

On December 21, 2018 the Attorney General filed a motion to compel Atmos to recalculate its proposed new depreciation rates based upon the Average Life Group ("ALG") procedure, which is utilized by virtually every utility in the Commonwealth, and to produce

[1] Atmos subsequently increased its revenue requirement to $14.509 million. *See* Atmos response to PSC 2-64.

the recalculated rates in discovery.[2] Following oral arguments which the Commission ordered to be held on this motion,[3] the Commission granted the Attorney General's motion.[4]

On January 28, 2019 the Attorney General filed testimony recommending, *inter alia*, that Atmos' base rates be <u>reduced</u> by $7.970 million.[5] The Attorney General also responded to data requests from Commission Staff, and from Atmos. An evidentiary hearing was held on April 2-3, 2019. Commission Staff issued post-hearing data requests to both Atmos and the Attorney General, and the Attorney General issued post-hearing data requests to Atmos. The Attorney General filed responses to all Staff data requests by April 12, 2019. However, Atmos did not complete the filing of its responses to post-hearing data requests until April 22, 2019.

Under Atmos' proposed rates, the average monthly bill for residential customers will increase by 8.6%, or approximately $4.41.[6] With Atmos expressing its intent to file base rate cases every year, such an increase does not comport with the Commission's preference for gradualism in ratemaking. Further, this type of annual increase would have a compounding effect on rate impact for the Kentucky families who take service from Atmos.

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[2] *See, e.g.*, Attorney General's Motion to Compel Discovery filed Dec. 21, 2018, and AG Hearing Exhibits 8 through 14.
[3] Commission's Order dated Jan. 8, 2019.
[4] Commission's Order dated Jan. 14, 2019.
[5] In response to Staff's Post Hearing Data Request ["PHDR"] to the Attorney General, item no. 7, the Attorney General on April 12, 2019 filed his revised revenue requirement model, which increased the amount of his recommended rate reduction to <u>$8.605</u> million. The following additional or modified adjustments, as discussed *infra*, all result in additional revenue requirement reductions: (a) removal of $148,405 of Supplemental Executive Retirement Program expenses allocated to Kentucky; (b) reducing Atmos' ROE to 9.45%, resulting in a revenue requirement reduction of approximately $721,000 in addition to the amount of Mr. Kollen's adjustment, which was based on an ROE of 9.7%; (c) the disallowance of all AFUDC included in plant in service costs that has accrued for accounting purposes since Atmos was allowed to include CWIP in rate base until the day before the effective date when base rates are reset in this proceeding, and the date it is actually authorized to accrue AFUDC for ratemaking purposes, resulting in a revenue requirement reduction of $255,700.
[6] Application, at 3–4; FR 17(4)(a), FR 17(4)(b), FR 17(4)(c).

II. ARGUMENT

1. OPERATING INCOME ISSUES

a. The Commission Should Set Atmos' Depreciation Rates Based on the ALG Procedure, Just as Virtually Every Kentucky Investor-Owned Utility Does

Utility depreciation rates are set utilizing one of the two primary methods: ELG or ALG.[7] Both procedures allow the utility to recover its full costs.[8] Both procedures are based on statistical techniques that are equally accurate, although each procedure relies on assumptions that may or may not be borne out by actual experience.[9] The key difference between the two is one of timing of depreciation expense and recovery.[10] Thus the amount of depreciation expense submitted for recovery in base rate proceedings can vary significantly depending on the procedure utilized to set depreciation rates. ELG front-loads cost recovery over the service life of an asset group, resulting in greater up-front depreciation rates and costs,[11] and in accelerated, shortened periods of capital recovery, especially if the utility had historically used ALG.[12] Under the ALG procedure, however, data is smoothed and normalized so that cost recovery occurs evenly over the service life of an asset group.[13] Such normalization results in predictable expense over the life of each asset group, a fair

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[7] *See, e.g.,* rebuttal testimony of Mr. Dane Watson, p. 5 lines 1-3.
[8] Direct testimony of Mr. Lane Kollen, pp. 10, 13; Watson rebuttal at p. 11, lines 14-15.
[9] *Id*. at 11-13.
[10] *Id*. at 10.
[11] The utility industry's perhaps most widely-recognized depreciation expert, Mr. John J. Spanos, has stated that, "ELG, will **every time** result in higher depreciation rates in early years than the ALG methodology." *In Re Electronic Application of Duke Energy Kentucky, Inc. for an Adjustment of Electric Rates, etc.,* Case No. 2017-00321, Rebuttal testimony of John J. Spanos, pp. 30-34 [emphasis added]. Moreover, Atmos' own depreciation witness, Mr. Watson, also demonstrates the front-loaded impact of ELG-derived rates in his rebuttal testimony, p. 7, lines 10-16.
[12] Kollen direct at 10-14.
[13] *Id*. at 13-14.

distribution in terms of intergenerational equity, and provides a recovery pattern that more closely matches the underlying depreciation expense.

In a recent fully-litigated base rate case, the Commission issued a definitive order addressing, *inter alia*, the differences between ELG and ALG, and expressly finding ALG to be the preferable procedure:

> ". . . the ELG procedure front-loads depreciation expense in earlier years and decreases it in the later years of an asset's depreciable life, creating a mismatch of revenues and expenses . . . Regulatory accounting requires the proper matching of revenues and expense in order to produce fair, just and reasonable rates. The Commission finds Duke Kentucky's proposed ELG procedure does not meet that criteria."[14]

The differences in the results achieved between the two procedures can be stark, as is vividly demonstrated in the proposed revenue requirement in the instant proceeding: if the ELG procedure is utilized, Atmos asserts it needs an additional $14.509 million in revenues; but if the ALG procedure is utilized, that sum *dramatically* decreases to $7.461 million, a difference of **over 48%**.[15] Given the unjust "mismatch of revenues and expenses" that occurs through the ELG procedure, the Commission has been correct over the years in requiring Kentucky investor-owned utilities to use the ALG procedure, which is the only way to ensure fair, just and reasonable depreciation rates. Undoubtedly, this is the reason why the use of ALG is so wide-spread in the utility industry.[16]

Given the reality that ELG-derived depreciation rates would have a revenue-bolstering impact, it should come as no surprise that Atmos continues to mischaracterize the ELG

[14] *In Re: Application of Duke Energy Kentucky, Inc. for an Adjustment of its Electric Rates, etc*., Case No. 2017-00321, Final Order dated April 13, 2018, pp. 10, 26-27 [footnotes omitted].
[15] *See* Atmos' "2018 KY Rev. Requirement Model," filed on Feb. 15, 2019, reflecting the use of the ALG procedure. *See also* Kollen direct at 14, wherein his initial calculation of the revenue requirement impact of using the ALG was a reduction of $7.133 million; and subsequently re-calculated in the Attorney General's April 12, 2019 filing to a reduction of $<u>7.405</u> million.
[16] Kollen direct at 7. *See also* AG Hearing Exhibits 8-14, indicating that virtually all of Kentucky's investor-owned utilities, including most Local Distribution Companies, utilize the ALG procedure.

procedure as somehow being more theoretically "accurate" merely because ELG can utilize more granular data and further isolate depreciable asset groups. However, the Commission should resist such siren songs, as the ELG procedure makes use of *subjective* judgment to define smaller sub-groups than the ALG procedure which is not merited by the data, by the further assumptions and judgment required, nor by the regulatory objective to match revenue recovery with the underlying depreciation expense. As Mr. Kollen cautions:

> ". . . although the ELG procedure requires a more refined stratification of the data, this stratification is itself the result of judgment and assumptions, which are subject to the discretion of the analyst and easily biased, whether intentionally or unintentionally. Thus, the claimed precision is illusory at best and biased at worst."[17]

Given Atmos witness Watson's agreement that both ELG and ALG methodologies provide full compensation,[18] it is difficult to envision how the former is somehow more accurate than the latter. Additionally, Atmos has provided no evidence that it has any depreciable assets with service lives of less than five years, blunting ELG's perceived effectiveness at maximizing any greater accuracy. As Mr. Kollen explained at the hearing, ALG does, in fact, take shorter lives of certain assets into account through its use of interim retirement curves.[19] The ALG procedure also recognizes the shorter lives of assets within an asset group through an interim retirement curve and assumes that the interim retirement pattern will be repeated throughout the service life of the group.

Moreover, the effect of ELG's front-loaded cost recovery is compounded in this case by the exponential growth of Atmos' capital spending. Such front-loaded depreciation expense for newly-installed assets compounds the real-world, bottom-line rate impact on

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[17] Kollen direct, p. 12.
[18] April 3, 2019 Video Transcript of Evidence ["VTE"] at 9:02:43 – 9:03:55.
[19] April 3, 2019 VTE at 10:41:20 – 10:42:50.

customers because Atmos is allowed to recover its capital expenditure costs, a return on those costs, and front-loaded depreciation. Thus the greater the capital expenditures, the greater the depreciation expense will be under ELG. The ALG procedure, however, would greatly mitigate customers' bottom-line rate impact.

Finally, Mr. Watson's assertion that this Commission has given ". . . long-standing approval of [ELG] for Atmos Energy, both through stipulated agreement and litigated proceedings,"[20] is yet another example of a "mismatch" of opinion with reality. In fact, the following synopsis of Atmos' use of the ELG procedure reveals that the Commission has indeed never affirmatively approved the use of the ELG procedure in lieu of the ALG procedure:

- Atmos claims that the Commission first approved its use of ELG in rate case 99-070. However, in that stipulated case, neither the stipulation, nor the final order approving the settlement mentioned anything *at all* regarding depreciation, much less the ELG procedure. Moreover, the Final Order expressly noted the non-binding nature of the settlement: "The parties agree that the Settlement is for the purposes of this case only and shall not be binding on the parties in any other proceeding before this Commission or in any court and shall not be offered or relied upon in any other proceeding involving Western or any other utility regulated by this Commission." [21]

- The application in Atmos' next rate case included testimony indicating that the ELG procedure was used in developing depreciation rates. That case, also, resulted in a settlement. However, the stipulation provided only a schedule of proposed depreciation rates, and was silent as to any methodology used for developing those settlement depreciation rates. With regard to the settlement depreciation rates, the Final Order approving the settlement stated only that those rates were a "negotiated hybrid" of the positions taken by Atmos and the Attorney General.[22] Moreover, just as in Atmos' immediately prior rate case, the Final Order noted, "The Commission's approval of the provisions of the Settlement Agreement is based solely on their reasonableness in toto and does not constitute precedent on any issue."[23]

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[20] Watson rebuttal, at 1.
[21] *In Re: Application of Western Kentucky Gas for an Adjustment of Rates*, Case No. 99-070, Final Order dated Dec. 21, 1999, at 2.
[22] *In Re: Rate Application by Atmos Energy Corp.*, Case No. 2006-00464, Final Order dated July 31, 2007, at 4.
[23] *Id*. at 6.

- Atmos' next rate case, filed in 2009, also resulted in yet another settlement, which stated that the Company would continue using the depreciation rates derived in its 2006 case. Additionally, the Final Order approving that settlement contained the same language of limitation: "Such approval is based solely on the reasonableness of the Stipulation in total and does not constitute a precedent on any individual issue or rate-making theory or adjustment." [24]

- The next Atmos rate case contained the Company's first depreciation study since 2006. The Final Order in that case, which was fully litigated, discussed depreciation only very briefly and no approval *of any type or sort* was given regarding the methodology Atmos utilized to develop those depreciation rates.[25]

- Atmos' last rate case utilizing a depreciating study also resulted in a settlement. The Stipulation in that case indicated that the Company's proposed rates, attached as a schedule to the Stipulation, are accepted. The Final Order approving the settlement stated, "Such approval is based solely on the reasonableness of the Settlement Agreement in total and does not constitute a precedent on any individual issue." [26]

Clearly, Atmos' characterization that the Commission has somehow "approved" its use of the ELG methodology since 1999 is ill-founded, at best. Not only has the issue never been actually litigated, but the Commission has never issued any order that even *remotely* delves into the merits of the Company's use of ELG. Even in cases in which the Commission approved new depreciation rates resulting from a settlement, the language of each such final order is clear that the settlement creates no binding precedent on the Commission, clearly negating Atmos' assertion.

The Commission is therefore not bound by any type or sort of precedent regarding the ELG procedure. Moreover, Atmos has not presented compelling evidence to justify the

[24] *In Re: Application of Atmos Energy Corp. for an Adjustment of Rates*, Case No. 2009-00354, Final Order dated May 28, 2010, at 8.
[25] *In Re Application of Atmos Energy Corp. for an Adjustment of Rates and Tariff Modifications*, Case No. 2013-00148, Final Order dated April 22, 2014, at 56-57.
[26] *In Re: Application of Atmos Energy Corp. for an Adjustment of Rates and Tariff Modifications*, Case No. 2015-00343, Final Order dated Aug. 4, 2016, at 5.

Commission deviating from its own established precedent in preferring ALG to ELG. And, as already stated, virtually all other investor-owned utilities in Kentucky currently use ALG. If the Commission reverses its own precedent and allows Atmos to continue to employ ELG, each of those other utilities will similarly fall in line to request the switch to ELG in order to take advantage of its accelerated recovery. Therefore, the Commission must definitively deny Atmos' proposal for ELG.

As set forth in Mr. Kollen's revised revenue requirement model,[27] the effect of mandating the ALG procedure in depreciation rates reduces the revenue requirement in this proceeding by $7.405 million.

b. Supplemental Executive Retirement Program Expenses Must be Removed as Contrary to Commission Policy

As set forth in Atmos' responses to various data requests,[28] Atmos is seeking to recover $148,405 in Supplemental Executive Retirement Program ("SERP") expense from its ratepayers. SERPs are non-qualified retirement plans for key employees, such as executives, that provide benefits above and beyond those covered in other retirement plans.[29]

> "[SERPs] are viable options for companies seeking to maximize key executives' retirement income. They are non-qualified and require no IRS approval and minimal reporting. The company controls the plan and is able to book an annual expense equal to the present value of the stream of future benefit payments. **When the benefits are paid, the company is able to deduct them as an expense**. When a cash-value life insurance policy is used to fund the benefits, the company benefits from tax-deferred accumulation inside the policy. In most cases, the policy can be structured in a way that allows the company to recover its cost. For executives, the plan can be tailored to meet their specific needs. The benefits accrue to

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[27] Attached in response to Staff's PHDR to the Attorney General, item no. 7.

[28] Atmos' response to PSC 4-9, "2018 KY REV REQ Model (1)," Schedule G-3, line 10. *See also* hearing testimony of Atmos witness Mr. Waller, April 2, 2019 VTE at 4:20:00 – 4:21:07; Atmos' response to the Attorney General's PHDRs to Atmos, item no. 7, and Atmos' response to Staff's PHDRs to Atmos, item no. 31.

[29] *See, e.g.*, https://www.investopedia.com/terms/s/serp.asp. Moreover, SERPs can also be structured as separate defined benefit, or defined contribution plans (*see, e.g.,* https://www.thehartford.com/business-playbook/in-depth/supplemental-executive-retirement-plans).

> the executive without any current tax consequences. When funded with a cash-value life insurance policy, the death benefits are available to provide a continued supplemental payment or a lump-sum payment to the executive's beneficiaries in the event of a premature death."[30]

Significantly, the Commission has repeatedly denied recovery of SERP expenses. As the Commission ruled in Case No. 94-355:

> "The Attorney General's second adjustment would reduce expenses by $41,789 for SERP costs directly incurred by Cincinnati Bell because the Commission has previously removed from cost of service the cost of plans when benefits for highly compensated employees exceed the pension plan for all employees." Not surprisingly, we find the adjustment should be accepted."[31]

The policy rationale for exclusion of SERP costs is identical to that which the Commission has recently used to deny recovery of any 401 (k) plan matching contributions that a utility makes on behalf of employees who also participate in a defined benefit plan.[32] In Case No. 2016-00169,[33] the Commission found: "The Commission believes all employees should have a retirement benefit, but finds it excessive and not reasonable that Cumberland Valley continues to contribute to both a defined-benefit pension plan as well as a 401 (k) plan for salaried employees."[34] In the instant case, Atmos' desire to recover SERP expenses from ratepayers, instead of shareholders, is an attempt to make an end-run around the Commission's prohibition against recovery of costs for multiple retirement plans. The Commission's existing policy of excluding expenses for multiple supplemental retirement

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[30] *Id.* [emphasis added].

[31] *In Re Application of Cincinnati Bell Telephone Co*., Case No. 94-355, p. 16. *See also, In Re Application of Louisville Gas & Electric Co*., Case No. 90-158, Final Order dated Dec. 21, 1990, p. 27, provided in AG Hearing Exhibit 6.

[32] *See, e.g., In Re Electronic Application of Louisville Gas & Elec. Co. for an Adjustment of Rates*, etc., Case No. 2016-00371, Final Order dated pp. 16-17.

[33] *In Re Application of Cumberland Valley Electric, Inc. for a General Adjustment of Rates*, Case No. 2016-00169, Final Order dated Feb. 6, 2017.

[34] *Id*. at 10.

programs available to salaried employees is even more crucial in the context of SERP, which is available exclusively to highly-compensated executives.

Moreover, utilities are *already* able to structure SERP-related expenses in such a manner that allows them to be deducted. Clearly, Atmos' desire in passing SERP expense onto its ratepayers is to provide its shareholders with a double recovery of SERP expense. The Commission should therefore exclude all jurisdictional SERP costs. The amount of SERP expense included in the forecasted test year is approximately $148,405.

c. Mr. Martin's Salary Should Be Disallowed Rate Recovery

During the hearing, the Attorney General questioned Mr. Martin on Atmos' lobbying activities in Kentucky.[35] Mr. Martin acknowledged that he is listed on the Kentucky Registered Legislative Employers list of March 26, 2019 as the in-state contact for Atmos Energy.[36] Mr. Martin testified that his role entailed some communication with Atmos' employed lobbyist, Mr. Ashcraft, and the filing of periodic reports required by the Legislative Ethics Commission, but he could not define how much of his time is spent on lobbying efforts, communication with the legislature, or communication with Atmos Corporate's government affairs unit in Dallas, Texas.[37]

The Attorney General asked as a post-hearing data request that Atmos define how much of Mr. Martin's salary is considered above the line, or paid for by ratepayers—to which the Company responded that "all of Mark Martin's salary is considered above the line."[38] Furthermore, despite being the Vice President - Rates and Regulatory Affairs for the

[35] April 2, 2019 VTE at 10:43:09—10:45:50.
[36] *Id.; see also* AG Exhibit 16.
[37] April 2, 2019 VTE at 10:43:09—10:45:50.
[38] Atmos' Response to AG PHDR Item 1-01.

Kentucky/Mid-States Division of Atmos Energy, Mr. Martin declined to answer questions regarding the Company's election of CWIP vs. AFUDC,[39] and the calculation of its rate base and revenue requirement in the instant filing,[40] instead referring those lines of questioning to Mr. Waller. For the reasons already stated, the Attorney General proposes that the Commission disallow the entirety of Mr. Martin's salary for ratemaking purposes.

2. RATE BASE ISSUES

a. Atmos Must Continue the PRP Rider, and Forecast Pipe Replacement Costs Should be Removed from Rate base and Operating Expenses in the Base Revenue Requirement

Atmos' last rate case was predicated in large part upon a massive capital expenditure program to be carried out through its Pipeline Replacement Program ("PRP").[41] The Commission found these forecasted expenditures to be "inconsistent" and founded upon "unsupported estimates."[42] In that case, Atmos built into its forecasted PRP expenses a 12% annual escalation rate [43]which, ". . . caused the Commission to question the reliability of the estimates and the reasonableness of the program as currently structured."[44] In fact, the PRP capital spending which Atmos had projected in that case would have resulted in a ***doubling*** of the company's entire rate base in just an 8-year time span, even assuming no growth in rate base from non-PRP capital expenditures.[45] Accordingly, the Commission found such future cost estimates to be "speculative," and instead ordered that Atmos' recovery of PRP

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[39] April 2, 2019 VTE at 10:46:20—10:47:20.
[40] *Id*. at 11:06:25—11:08:50.
[41] Case No. 2017-00349.
[42] *Id*., Final Order issued May 3, 2018, at 41.
[43] Case No. 2017-00349, Martin rebuttal testimony at 9; and questioning from Vice Chairman Cicero, March 22, 2018 VTE 10:15:00 – 10:16:40; 10:46:56 – 10:47:25.
[44] Case No. 2017-00349, Final Order issued May 3, 2018, at 41-42.
[45] *See, e.g.,* Case No. 2017-00349, Kollen direct testimony, at 70-75. Moreover, Atmos' projected capital spending in that case would have led to a 62.5% increase in the Company's margins from 2018-2022. *See* Case No. 2017-00349, Atmos' response to PSC 2-3, Attachment 1.

investment should instead be based upon actual, historic spending of no more than $28 million annually, and that budget estimates would no longer be accepted.[46] The Commission agreed with the Attorney General that Atmos' recovery of future investment should be limited, and that it could be limited without risk to public safety by extending the timeframe of the original 15-year PRP program by an additional two years.[47] The Commission's actions in that case thus focused on the scope and timing of the PRP itself, and the magnitude of the costs recoverable through the PRP Rider. As Mr. Kollen noted, the Commission-imposed changes in the Final Order of Case No. 2017-00349, "provide essential customer safeguards and inherent incentives to reasonably manage and minimize the PRP costs." [48]

In the instant case, however, Atmos seeks to re-establish its extraordinary capital spending program by merely re-branding it as "Non-PRP" spending. In addition, the Company seeks to: (a) eliminate its between-rate cases PRP Rider that it requested and was granted in 2010 in order to minimize what it claimed was lagged cost recovery,[49] and instead proposes to recover replacement costs for bare metal pipe through annual base rate cases utilizing fully-forecasted test years, and (b) ostensibly continue the Commission-mandated $28 million annual cap on PRP spending, in principle. Costs for replacing all other types of pipes would fall under the meaningless "Non-PRP" category. Whereas the Company asserts that its instant application satisfies all Commission-imposed requirements set forth in the Final Order in Case No. 2017-00349, the Attorney General states that the application is a two-fold attempt to circumvent the Commission's authority, and to return the Company to its original track to reap unfair and unjust profit at a brazen pace.

[46]Case No. 2017-00349, Final Order issued May 3, 2018, at 42, and Ordering Paragraph 6 at 47.
[47] *Id.* at 40-41.
[48] Kollen direct, at 19-20.
[49] Case No. 2009-00354, Final Order dated May 28, 2010, at 8.

First, Atmos proposes significant changes to the timing of cost recovery. Rather than limiting PRP costs to the actual costs incurred through the historic period ending September 30, 2018, the Company's new proposal in this case is to recover in rate base both those costs, as well as forecast PRP costs from October 1, 2018 through March 31, 2020. Thus, rather than limiting total cost recovery to $28 million as the prior Order required, Atmos now seeks to include an *additional $42 million* in PRP costs from October 1, 2018 through March 31, 2020 in the base revenue requirement.[50] Yet if Atmos had followed the Commission's directives set forth in the last rate case's Final Order, the PRP costs incurred from October 1, 2018 through September 30, 2019 would not be eligible for recovery through the PRP Rider until March 1, 2020, and the costs incurred from October 1, 2019 through March 31, 2020 would not be eligible for recovery through the PRP Rider until March 1, 2021.[51]

Clearly, Atmos is seeking to move the goal posts in an effort to maximize its capital investment, and to bypass the Commission's cost recovery restrictions. Atmos' proposed changes to recovery of pipe replacement costs purposefully circumvent the Commission's ratepayer safeguards imposed in Case No. 2017-00349. The Commission must not reward such sleight of hand, especially given Atmos' history of chronically underestimating the true cost of pipeline replacement on its system. Instead, the Commission should direct Atmos to continue recovering PRP program costs in accordance with the manner prescribed in the last rate case's well-reasoned Order. The effect of Mr. Kollen's proposed adjustment in this regard is a reduction of $3.598 million in the base revenue requirement. [52]

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[50] $28 million in fiscal year 2019 from October 1, 2018 through September 30, 2019 plus $14 million in fiscal year 2020 from October 1, 2018 through March 31, 2020. *See* Kollen direct at 17 for a chart illustrating the impact of Atmos' proposed timing changes on its cost recovery. *See also* Atmos' response to Staff 3-22.
[51] Kollen direct, at 16-18.
[52] Consisting of a reduction of $2.916 million for the return on rate base, a reduction of $0.488 million in depreciation expense (grossed-up from $0.485 million and quantified using the ALG depreciation rates to avoid

b. Atmos' Unprecedented Increase in Capital Spending through the "Non-PRP" Category Must be Reigned-In and Reduced to Reasonable Levels

The second manner in which Atmos is attempting to circumvent the Commission's imposition of clear restrictions on the levels of capital spending for pipe replacement which it established in Case No. 2017-00349, is through the separate category of capital spending the Company now deems "Non-PRP" spending. As set forth in the table below,[53] there is no meaningful difference in the levels of total (PRP plus non-PRP) projected capital spending from Atmos last rate case, to the forecast spending in the instant case.[54]

$ millions Fiscal Year		PRP Investment		Non PRP Investment		Total Direct Investment	PRP as % of Total
2013	$	17.2	$	18.3	$	35.5	48%
2014		22.7		26.6		49.3	46%
2015		36.9		18.6		55.5	66%
2016		30.0		34.2		64.2	47%
2017		39.9		33.0		72.9	55%
2018		45.9		33.9		79.8	58%
2019		28.0		58.7		86.7	32%
2020		28.0		68.7		96.7	29%

As depicted above, the Company's PRP spending escalated in the period 2016-2018, until the Commission issued its Order in Case No. 2017-00349, capping PRP spending at $28 million annually. From 2015-2016, Non-PRP spending nearly doubled, then remained relatively constant during the period that PRP spending escalated. In the timeframe immediately following the issuance of that Final Order, Atmos' new plan to circumvent the impact of the Order ("Circumvention Plan") is graphically depicted in the jump in Non-PRP spending from $33.9 million in 2018 to a projected $68.7 million by 2020, an increase of

double counting in Mr. Kollen's quantifications), and a reduction of $0.194 million in ad valorem expense (grossed up from $0.193 million).

[53] Provided in Atmos' response to Staff 3-22.

[54] In his hearing testimony, Atmos witness Waller acknowledged this lack of any meaningful difference. April 2, 2019 VTE at 3:55:22 – 3:56:10.

102.6% in just two years. As a result of Atmos' implementation of its Circumvention Plan, forecasted Non-PRP investment in 2020 is $50 million more than the actual Non-PRP investment in 2015, constituting an approximately ***270%*** increase in just five years. Even when taking the Commission's significant PRP-spending restrictions into consideration, forecasted total direct investment (PRP and Non-PRP combined) by 2020 will be 74% higher than in 2015 ($96.7 million vs. $55.5 million). As Mr. Kollen noted, "Atmos has met the Commission's attempt to limit the annual PRP investment to $28 million with staggering increases in annual Non-PRP investment."[55] Such gargantuan increases in capital spending for a utility experiencing virtually no customer growth cannot be allowed to go unchecked.

Moreover, such massive increases in projected capital expenditures is creating a generational inequity for Atmos' ratepayers:

> "It does not make sense for the Company's existing customers to pay to replace much of the Company's existing system and *to more than double rate base and the related expenses* (depreciation expense, ad valorem tax expense, and income tax expense) *in the next four to six years*. The Commission should encourage prioritization of capital expenditures and the exercise of control over these costs and operating expenses through the behavioral and financial incentives available in the ratemaking process."[56]

Additionally, despite Atmos' previous assertions otherwise,[57] the Company later confirmed that it does not currently have specific projects for the last six months of the test year (October 2019–March 2020).[58] Rather, it simply used the same total monetary amount from that same previous six-month period (October 2018–March 2019), and then allocated this total to FERC plant accounts based on the same historic account distribution for the

[55] Kollen direct at 23.
[56] *Id.* at 25 [emphasis added].
[57] April 2, 2019 VTE at 1:32:12—1:35:52.
[58] *See* Atmos Response to AG PHDR, Item 1-02.

earlier six-month period.[59] Instead of using this six-month period to project test year capital expenditures, the Attorney General recommends that Atmos' Non-PRP spending should be limited to its historic three-year average. Atmos should not be rewarded for making needs-based claims for specific projects that have not been actually identified in its filing or vetted in any way.

The Commission should also note that Atmos' CWIP in rate base approach,[60] coupled with its proposal to continue use of ELG-derived depreciation rates will only enhance and compound the front-loading of such largely unnecessary expenses onto the current generation of ratepayers. The Commission should therefore reduce the forecast Non-PRP capital investment allowed in the test year to a reasonable amount, based on the Company's most recent three-year actual Non-PRP expenditures. This action should be taken in conjunction with Mr. Kollen's other recommendations to reject the Company's request to terminate the PRP Rider and to affirm the limitations on PRP costs and PRP Rider recovery that the Commission imposed in Case No. 2017-00349. The effect is a reduction in the base revenue requirement of $3.207 million.[61]

c. Construction Financing Expenses Must be Capitalized as AFUDC and Recovered Over the Assets' Service Lives, and No-Longer Included in CWIP in Rate Base, and Prematurely Recovered During the Construction Period

Atmos utilizes a "CWIP in rate base approach" in which it seeks current recovery of construction financing costs for ratemaking purposes instead of capitalizing these costs in CWIP and then recovering the costs over the service lives of the assets. Under this approach, the Company recovers construction financing costs prior to the date a given construction

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[59] *See* Atmos Response to AG PHDR, Item 1-02.
[60] Discussed in further detail, *infra.*
[61] *See* Kollen direct at 26-27 for a breakdown of the components of this adjustment.

project is completed and placed in service. Although the Commission has historically allowed the Company to include CWIP in rate base for *ratemaking* purposes and to recover the grossed-up return on CWIP in the base revenue requirement, Atmos nonetheless actually records AFUDC for *accounting* purposes. Atmos did remove the AFUDC included in CWIP in the test year,[62] but it did not remove the AFUDC recorded in CWIP prior to the test year, which is now included in plant in service for accounting purposes *and* in rate base for ratemaking purposes.[63]

The problem with Atmos' approach is that it allows double recovery of a portion of its construction financing costs, first through the return on the CWIP in rate base, and then a second time, by capitalizing the costs as AFUDC and recovering them through depreciation expense, along with a return on the AFUDC until it is fully depreciated. Utilities following the CWIP in rate base approach generally are not allowed to record AFUDC for either accounting or ratemaking purposes. Thus the AFUDC and CWIP in rate base approaches are considered mutually exclusive.[64] At the evidentiary hearing, Atmos witness Waller agreed that the Company had incorrectly accrued AFUDC even though it was allowed CWIP in rate base and agreed that the Company would correct this historical error.[65]

The AFUDC approach is clearly superior and would benefit both the Company and its customers. First, AFUDC provides a utility dollar-for-dollar recovery of its actual construction financing costs, no more and no less. Second, whereas the CWIP in rate base approach provides *accelerated recovery* of the construction financing costs during the

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[62] Waller direct at 13.
[63] Kollen direct at 28 (*citing* Waller direct at 7-9, and Atmos' response to AG 2-18).
[64] In his hearing testimony, Atmos witness Waller acknowledged the mutually exclusive nature of the AFUDC CWIP in rate base approaches. April 2, 2019 VTE 3:34:12 – 3:39:37.
[65] April 2, 2019 VTE at 3:36:40 – 3:38:22.

construction period rather than over the service lives of the assets, AFUDC is consistent with the GAAP requirement to capitalize these construction financing costs and then depreciate the costs *over the asset's service life*, meaning that cost recovery occurs over the service life.[66] In this manner, AFUDC thus avoids the premature recovery of these costs during the construction period before the assets provide service, minimizes base rate increases, and allows customers to pay for these costs over the assets' service lives when they are used and useful. Third, the CWIP in rate base approach penalizes customers by requiring the Company to pay income tax expense on the equity component of the return during the construction period, which clearly provides no benefit to the Company or its customers. Fourth, most other Kentucky investor-owned utilities either exclude CWIP from rate base, or from capitalization.[67] Finally, AFUDC provides the Company a return on its PRP and non-PRP capital expenditures during the entire construction period, thus reducing any effects of regulatory lag. It provides the Company an exact match between its actual construction financing costs and the future recovery of those costs, no more and no less.

The Attorney General recommends that the Commission: (a) exclude CWIP from Atmos' rate base and direct the Company to accrue AFUDC starting with the effective date when base rates are reset in this proceeding for ratemaking purposes, utilizing the same methodology the Commission applied in the most recent base rate case filings of Duke Energy Kentucky, Inc. (electric and gas)[68] and Columbia Gas of Kentucky, Inc.; [69] and (b) disallow

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[66] As Mr. Kollen noted, "The revenue requirement is set to recover the depreciation expense plus a return on the declining rate base as the asset is depreciated for book accounting and tax purposes. The AFUDC approach correctly allocates the total cost over the service life of the assets to the customers who are served by the asset." Kollen direct at 31.
[67] *See* Kollen direct at 31-34 for a discussion regarding the methodologies the Commission utilizes for this purpose.
[68] See Exhibits___(LK-5), (LK-6), and (LK-7) attached to Mr. Kollen's direct testimony.
[69] *See* Exhibit ___(LK-8) attached to Mr. Kollen's direct testimony.

all AFUDC included in plant in service costs that has been accrued for accounting purposes since Atmos was allowed to include CWIP in rate base until the day before the effective date when base rates are reset in this proceeding and it is actually authorized to accrue AFUDC for ratemaking purposes. The effect of part (a) of this recommendation is a reduction of $3.921 million in the base revenue requirement.[70] The effect of part (b) of this recommendation is a reduction of $255,700 in the base revenue requirement.[71] The Attorney General calculated part (b) this adjustment based on the data in the attached Attorney General's Brief Exhibit 1.[72]

d. Inclusion of Non-Cash Costs in Lead-Lag Calculations Overstates Atmos' Cash Working Capital

In order to determine its Cash Working Capital ("CWC") allowance, Atmos in this case conducted a lead-lag study.[73] However, that study was performed incorrectly. First, it included several items of significant cost that are clearly non-cash in nature: depreciation expense, deferred income tax expense, and the non-dividend component of the return on equity.[74] As Mr. Kollen explained:

> Fundamentally, the lead/lag study measures the *cash* investment provided by either investors (positive) or customers (negative) on average over the course of the study period. The return on non-cash expenses,

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[70] Kollen direct testimony at 35.

[71] Atmos provided the amount of recorded AFUDC additions and retirements for 2006 through 2018 for both the Shared Services Divisions (002 and 012) and the Kentucky Division (009) in response to Staff 5-10 and confirmed these amounts in response to AG PHDR 1-04. The AG added the net additions and retirements from the Kentucky Division to the amount of net costs allocated from the Shared Services Divisions utilizing the as-filed Kentucky Division allocation percentages of 5.18% and 5.64% for Divisions 002 and 012, respectively. The sum total of the net additions and retirements was $2,112,592. That total multiplied by the AG's recommended grossed up rate of return of 8.90% yields a revenue requirement reduction of $188,097 related to the return on net AFUDC incorporated in rate base. Depreciation expense incorporated in the test year related to the net AFUDC was computed to be $67,603 based on the average ALG depreciation rate of 3.20%. The total revenue requirement, return of and on, associated with the historical AFUDC to remove is $255,700.

[72] These calculations are based upon Atmos' response to PSC 5-10, Attachment 1.

[73] The summary results of which are attached as Exhibit___(LK-9) to Mr. Kollen's direct testimony.

[74] In his hearing testimony, Atmos witness Christian acknowledged that these three items are all non-cash items. April 3, 2019 VTE at 9:58:00 - 9:58:45.

> such as depreciation and deferred income tax expenses is reflected in the return on rate base. The cash disbursement was made when the construction or acquisition cost was incurred and capitalized as CWIP or plant in service. There will never be a cash disbursement for depreciation or deferred income tax expense. The net accumulated depreciation and accumulated deferred income taxes are subtracted from rate base, but only on a lagged basis. This allows the Company to retain the carrying charge value of these non-cash expenses between rate cases. The non-dividend component of the return on equity also is non-cash by definition and represents the equity investor's expectation of growth in the value of the utility's stock. Investors are compensated for this component of the return on equity when they sell their stock. The holding period is indefinite.[75]

More specifically, the Company assumed zero expense lag days for depreciation expense, deferred income tax expense, and the non-dividend component of the return on equity.[76] This means that the Company assumes these fundamentally non-cash items will be paid *in cash* the very second they are incurred. Clearly, such a result is impossible. Instead, the correct expense lag days should have been infinity, which is greater than the revenue lag days. Thus, as a practical matter, the correct approach is either to set the net revenue lag/expense lag days to 0 days or remove the non-cash expenses altogether. The result is the same, *i.e.,* to remove *non-cash* expenses from the *cash* working capital calculation.

Second, Atmos incorrectly asserted an expense lag of zero days for the dividend component of the return on equity. Since Atmos pays dividends quarterly, the expense lag should instead be 118.6 days. As Mr. Kollen explained:

> The Company does not immediately pay the dividend the [very] second this cost is incurred and recognized in the revenue requirement. To the contrary, the service period each quarter is 45.6 days (365 days divided by 4 divided by 2). Atmos typically pays its quarterly dividends approximately nine weeks after the end of the quarter. Atmos paid its last

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[75] Kollen direct at 36-37 [emphasis in original]. In his hearing testimony, Atmos witness Christian acknowledged that lead-lag studies measure investment in terms of cash provided by either investors or customers. April 3, 2019 VTE at 9:57:45 – 9:58:04.

[76] In his hearing testimony, Atmos witness Christian acknowledged that the Company assumed zero expense lag days for these three items. April 3, 2019 VTE at 9:59:28 – 9:59:35.

> dividend on December 12, 2018, 73 days after the end of the fourth quarter in its fiscal year 2018. Thus, the dividend component of the return on equity expense lag days is 118.6 days, consisting of the 45.6 days for the service period plus the 73 days payment lag.[77]

In accordance with Mr. Kollen's recommendation, the Attorney General recommends that the Commission set the Company's cash working capital at negative $5.503 million based on the Company's lead/lag study, adjusted to remove the non-cash expenses, including depreciation expense, deferred income tax expense, and the non-dividend component of the return on equity, and adjusted to include 118.6 expense lag days for the dividend component of the return on equity. This yields a reduction of $8.195 million compared to the Company's proposed CWC, and reduces the revenue requirement by $0.821 million.[78]

3. COST OF CAPITAL ISSUES

a. Common Equity Ratio is Far Out of Proportion to Atmos' Needs and Far in Excess of its Peer Companies

Just twelve months ago, the Commission approved a capital structure for Atmos that provided a common equity ratio of 52.57%.[79] In the instant case, however, Atmos seeks an astounding increase in its common equity ratio to 58.24%. An increase of such a magnitude is unreasonable, unnecessary and significantly increases the cost of capital and base revenue requirement, as well as the PRP Rider revenue requirement. As Mr. Kollen cautions, "The cost of equity is significantly greater than the cost of any other component of the capital structure. In addition, the cost of common equity must be grossed-up for income taxes, making it even more costly than it appears."[80]

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[77] Kollen direct at 37-38, footnote omitted [*citing* https://www.nasdaq.com/symbol/ato/dividend-history].
[78] *Id.* at 38-39.
[79] Case No. 2017-00349, Final Order dated May 3, 2018, p. 30.
[80] Kollen direct at 40.

The Attorney General in AG 1-19 asked Atmos to provide the common equity ratios of Atmos witness Dr. Vander Weide's proxy group. In response, Atmos stated that it did not have this information, but it was available through each individual company's publicly available SEC Form 10-K filings.[81] The Attorney General did as Atmos suggested by reviewing the most recent Form 10-K filings of each proxy group company. The data results are compiled in AG Hearing Exhibit 7.[82] Since some of the proxy companies submitted their Form 10-K filings only a few weeks after the Attorney General filed Mr. Kollen's testimony, AG Hearing Exhibit 7 likely contains the most recently available data. Based on that data, the calculated average common equity ratio for the proxy group is ***50.2%.*** As a result of this research regarding the most-recent common equity ratios of the proxy group, the Attorney General now recommends that the common equity ratio be set at 50.2% (including short-term debt), but in no event be set greater than the 52.57% approved in the last case a mere 12 months ago.[83]

b. Long-Term Debt Issuances

As discussed by Mr. Kollen, on October 4, 2018 Atmos issued $600 million in senior notes at 4.3%, due in 2048.[84] However, Atmos failed to include this long-term debt issuance in its forecast cost of capital.[85] The effect of correctly including this new issuance in the capital structure reduces the revenue requirement by $1.506 million. Additionally, Atmos forecasts a new long-term debt issuance of $450 million, plus another $63 million for credit swap instruments (for a total of $513 million) at 5.07% and a reduction of $450 million for the

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[81] Atmos' Response to AG 1-19.
[82] AG Hearing Exhibit 7, "Common Equity Ratios for Companies in Vander Weide Proxy Group."
[83] April 3, 2019 VTE at 10:24:18 – 10:25:51.
[84] Kollen direct at 42 (*citing* Atmos' 2018 10-K, p. 58, attached as Exhibit __(LK-11) to his testimony).
[85] Kollen direct at 42.

retirement of a matured senior note at 8.5%.[86] However, given that the 30-year Treasury yield is 3.1%, Atmos' forecast rate of 3.782% is clearly unreasonable. Instead, Mr. Kollen recommends the Commission utilize a forecast interest rate of 4.392% for the new debt issue, consisting of 3.1% for the present 30-year Treasury yield plus the Company's proposed credit spread of 1.0% plus the Company's estimated fees of 0.292%.[87] The Attorney General adopts Mr. Kollen's recommendation. [88]

Atmos witness Mr. Christian's rebuttal testimony recognizes a revised actual long-term debt rate of 4.56% for both the October 2018 and March 2019 actual debt issuances.[89] The Attorney General agrees with Atmos' updated long-term debt rate.[90]

c. Atmos' Proposed Changes to the Capital Structure Direct More of its Required Rate of Return to Shareholder Profits

During the Attorney General's cross-examination, Company witness Waller confirmed that from the base period 13-month average used in Case No. 2017-00349, to the forecasted 13-month average in the present case, Atmos is adding approximately $126.5 million to its rate base.[91] He further agreed that the operating income impact of the increase in rate base between these two amounts could be calculated by multiplying the difference ($126.5 million) by the required rate of return (7.95%), and then multiplying that product by the gross revenue conversion factor (1.34184), which equaled approximately $13.5 million.[92]

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[86] Id. at 43-44 (*citing* Sch. J-3F).
[87] Id. at 44.
[88] Id. at 45.
[89] Christian rebuttal at 11.
[90] Kollen direct at 42-45.
[91] VTE at 3:19:55—3:30:30; AG Exhibit 17 (Atmos witness Waller noted that an updated version of these exhibits were filed along with his rebuttal testimony. In the updated version of these documents, the forecasted 13-month rate base average increased by $37,914, the required rate of return decreased by .02% to 7.93%. For the purposes of the Attorney General's line of questioning though, the results remain approximately the same).
[92] *Id.*

By multiplying the $126.5 million increase in rate base by the portion of the required rate of return that represents common equity (6.06%), multiplied by the gross revenue conversion factor (1.34184), Mr. Waller agreed that the resulting $10.3 million represents the portion of the increase in base rates between these two time periods that purely encapsulates shareholder profits.[93] Said succinctly, of the $13.5 million revenue requirement impact resulting from cost of capital return on new rate base since the beginning of the last rate case, $10.3 million of it -- or 76% -- relates exclusively to shareholder return. By proposing a capital structure which increases the common equity portion above 58%, Atmos has ensured that more of the returns from its swelling rate base inure to shareholders at the ultimate expense of ratepayers. With an ever-increasing rate base, compounded by annual rate cases, the Commission must disincentivize the increases related to shareholders by reducing the common equity portion of the capital structure to 50.2%, or capping the equity portion at 52.57% for ratemaking purposes, as argued *supra*.

d. Atmos' Requested Return on Equity is Unreasonable

Based on the testimony of Atmos Witness Dr. Vander Weide, Atmos proposes a 10.4 percent return on equity ("ROE"),[94] a reduction from its 10.6% request in April 2018.[95] In 2018, instead of the inflated 10.6% company-requested ROE, the Commission awarded Atmos a 9.7% ROE for a test-year ending *just weeks ago* on March 31, 2019.[96] In awarding a 9.7% ROE, the Commission indicated that although the economy was improving and the Federal Reserve federal funds rate was expected to increase, "increases in the federal funds

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[93] *Id.*
[94] Direct Testimony of James H. Vander Weide, Ph.D. ("Vander Weide Direct") (Ky. PSC Sept. 28, 2018) at 4.
[95] Case No. 2017-00349, Final Order dated May 3, 2018 ("2017 Atmos Order") at 27.
[96] 2017 Atmos Order at 29.

rate are not guaranteed."[97] Indeed, not only are such increases in the federal funds rate not guaranteed, but the periodic increases in them were actually halted since Atmos' last rate case.[98] Long-term interest rates have not increased, but rather, they have *decreased* since Atmos' rates were last set 11 months ago.[99] Additionally, the average litigated and awarded ROE in 2017 was 9.82%, while through September 2018 it was 9.62%.[100] Although the Attorney General agrees that capital costs are on the move, it is obvious that the direction is *down*, not up.

Not only do market changes support a different equity cost that that for which Atmos advocated, but Dr. Vander Weide's underlying numbers do as well. Removing flotation cost adjustments alone from the ROE calculations reduces the average cost rate by 20 basis points.[101] The Commission has never allowed for a flotation cost adjustment,[102] including explicitly denying it in Atmos' most-recent rate case in which Dr. Vander Weide advocated for its inclusion.[103] In addition to his inclusion of flotation cost adjustments, Dr. Vander Weide has also inflated his DCF analysis again in this case by using a quarterly DCF calculation.[104] Providing an incremental premium to shareholders in order to reflect the return they *may* receive should they *choose* to reinvest dividends *if* and *when* they receive them quarterly is nonsensical and inherently unfair to customers. Additionally, based on the assumption that interest rates will definitely rise "as the Federal Reserve raises interest rates,"

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[97] 2017 Atmos Order at 29.
[98] Atmos Responses to Staff PHDR 1-17.
[99] Commission Staff Hearing Exhibit 1.
[100] Kollen direct, Exhibit LK-15, page 9 of 13.
[101] Atmos Response to Staff DR 2-54.
[102] April 2, 2019 VTE at 9:25:25. In addition, no other state in which Atmos operates has ever awarded flotation costs or a size premium adjustment. *See* Atmos' responses to Staff PHDRs 1-18 and 1-20.
[103] 2017 Atmos Order at 29.
[104] Vander Weide Direct at 24.

Dr. Vander Weide's calculations are further inflated by using forecasted interest rates.[105] The Commission has recently and consistently held that rather than hoping for higher rates, "models supporting the low interest rate environment should be given more weight than those supporting high interest rates expectations."[106]

Rather than increasing Atmos' ROE, the evidence of record in this matter supports *decreasing* Atmos' current 9.7% ROE. First, Atmos' expert testimony in both the last case and the current one indicates that the investors' required rate of return has decreased by at least 20 basis points (10.4%[107] from 10.6%[108]) in the past year. Second, given Atmos' stated intent to file annual rate cases, the Commission must adjust Atmos' ROE downward for the resulting reduction in risk. As opposed to capital trackers like a PRP, annual rate cases with forecasted test-years provide for recovery of all forecasted capital costs, recovery of forecasted operating expenses and an ability to argue for and possibly receive increases in the allowed rate of return. The Commission has previously considered the issue of frequent forecasted rate cases, albeit less frequent than the annual schedule employed by Atmos, and reduced the utility's allowed ROE accordingly. [109] In that matter, the Commission noted that the "frequency of rate case applications . . . clearly demonstrated management's focused efforts to minimize regulatory risk and the risk associated with the recovery of capital investments."[110] The Commission went on to note that the use of a forecasted test period "tends to reduce the risk associated with the recovery of capital investments."[111] With annual

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[105] Vander Weide Direct at 33.
[106] *In re: Electronic Application of Kentucky Power Co. for a General Adjustment of Rates,* etc., Case No. 2017-00179, Final Order dated Jan. 18, 2018 (Ky. PSC Jan. 18, 2018) at 28.
[107] Vander Weide Direct at 4.
[108] 2017 Atmos Order at 27.
[109] *In Re: Application of Kentucky-American Water Co. for an Adjustment of Rates Supported by a Fully Forecasted Test Year,* Case No. 2010-00036, (Ky. PSC Dec. 14, 2010).
[110] *Id.* at 71.
[111] *Id.*

forecasted rate cases, what risk is Atmos actually taking on to warrant any equity premium over its cost of debt?

Finally, Dr. Vander Weide's results employing the methodology most-used by the Commission in determining ROE historically, the DCF analysis,[112] not adjusted for size premium or flotation costs, indicates a 9.44% required return.[113] The Attorney General is unaware of the Commission ever explicitly approving the use of Risk Premium methods in determining ROE, and in a 2013 case before this Commission Dr. Vander Weide "rejected" his own CAPM analyses because the beta coefficient for the proxy group "was significantly below a value of 1."[114] Notably, in this case the beta for Dr. Vander Weide's natural gas proxy group is .69,[115] thus by Dr. Vander Weide's own testimony his CAPM analyses in this matter must be rejected. As this Commission has never found Risk Premium models to be reasonable, and because Dr. Vander Weide inexplicably relied upon CAPM analyses with attributes he has previously indicated warrant rejection, the Attorney General recommends the Commission only consider his DCF result. Dr. Vander Weide's DCF result, modified for the removal of flotation cost and size premium adjustments, and understanding it is inflated due to quarterly compounding of dividends, is a much better measure of actual investor expectations than the other ROE evidence Atmos advanced.

Therefore, the 9.44% unadjusted, quarterly compounded DCF result, coupled with Atmos' implicit recognition that equity costs rates have decreased by at least 20 basis points

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[112] *See e.g.,* Case No. 10498 (Ky. PSC Oct. 6, 1989) stating, "[t]he Commission has traditionally used the DCF model in estimating ROE. Although one cannot rely on a strict interpretation of the DCF model, the Commission finds that the DCF approach will provide the best estimate of an investor's expected ROE."
[113] Atmos Response to Staff PHDR 1-22.
[114] *In Re*: *Application of Kentucky-American Water Co. for an Adjustment of Rates Supported by a Fully Forecasted Test Year,* Case No. 2012-00520 (Ky. PSC Oct. 25, 2013) at 46.
[115] Vander Weide Direct at 45.

since the Commission awarded Atmos an ROE of 9.7% last year, indicate an ROE of 9.45% is reasonable. An ROE of 9.45% is within the range of unadjusted results of all of Dr. Vander Weide's methodologies,[116] even though some of those methods improperly employed additional inflating measures, such as forecasted interest rates and quarterly compounding of dividends. There is no evidence in the record that Atmos has been unable to properly attract capital with a 9.7% ROE, with the evidence instead actually indicating that the Company is attracting and investing unreasonably high levels of capital.[117] With the understanding that Atmos will now seek annual rate cases using forecasted test years, the Attorney General recommends the Commission *lower* Atmos' ROE from the current 9.7% to 9.45%.

4. COMPOSITE FACTORS FOR DIVISIONS 002 and 091

Atmos' shared services costs are allocated through the use composite factors. Costs incurred at the corporate office division are allocated to the Kentucky/MidStates Division in the filing using one composite factor, while costs allocated from the corporate office division to the Kentucky/MidStates Division, together with costs incurred directly by the Kentucky/MidStates Division, are subsequently allocated to Kentucky using another composite factor. Atmos calculates the composite factors using three equally-weighted components for each division that receives an allocation of its costs: (a) gross direct property plant and equipment; (b) average number of customers; and (c) total O&M expense.[118]

Atmos uses various versions of the composite factor, *e.g.,* all companies, utility, and regulated only, among others, to allocate costs from the Corporate Office Division. In the filing, Atmos calculated a composite factor of 10.40% and allocated costs from Division 002

[116] Atmos Response to Staff PHDR 1-22.
[117] *See, e.g.*, April 2, 2019 VTE at 3:19:55—3:30:30; and Atmos' response to Staff 3-22
[118] Kollen direct at 48 (*citing* to Exhibit GKW-1 attached to Mr. Waller's Direct Testimony, the calculations for which were provided in response to Staff 2-37 and "WP FY17_Composite_Factors_for_Rates_Final").

to Division 091 using this factor. Atmos calculated a composite factor of 5.18% and allocated the Division 002 costs allocated to Division 091, together with the costs incurred directly by Division 091, to the Kentucky jurisdiction using this factor. [119]

However, only one of the three composite factor components is reasonable: gross direct property plant and equipment. The number of customers component is not reasonable because customer costs are incurred in a separate Call Center customer support division (012). The costs of Division 012 are appropriately allocated to Kentucky using a customer allocation factor. The total O&M component is not reasonable because it is not a comprehensive measure of all expenses managed by Division 002.[120]

In place of components for number of customers and total O&M expenses, a better and more comprehensive measure of expenses incurred at the Corporate Office Division would be total operating expense, which includes O&M, excluding allocations from Divisions 002 and 012), other taxes, depreciation and amortization expenses.[121] The total operating expense component is a reasonable proxy for the operating expenses included in the filing, and gross direct property plant and equipment serves as a reasonable proxy for rate base and total operating expenses.

The Commission should modify the composite factor so that it is equally weighted between gross direct property plant and equipment and total operating expenses. This will improve the composite factor so that it provides an allocation to Kentucky based on a comprehensive measure of the corporate office and Kentucky/Mid-States management and

[119] *Id.* at 48-49.
[120] *Id*. at 49.
[121] *Id*.

provision of services to Kentucky. The net effect is a revenue requirement reduction of $0.725 million.[122]

5. RATE DESIGN

a. Atmos' COSS Indicates No Increase in Residential Customer Charge is Warranted

Atmos has not presented any evidence which demonstrates that the current residential customer charge is insufficient for the Company in meeting its revenue requirement. The Company proposes the same increase for residential customers, to $20.50 per month that it proposed in Case No. 2017-00349. In its Final Order of that case, the Commission rejected an increase opining that, "Atmos's currently approved monthly base customer charges of $17.50 and $44.50 for the G-1 Firm Sales Service base residential and non-residential customer charges, respectively, continue to be reasonable based on the COSSs submitted by Atmos. . . As discussed herein, Atmos's monthly base customer charges should, therefore, remain at their current levels for all customer classes." [123]

In the instant case, Atmos witness Paul Raab puts forward the customer charge increase to residential customers to $20.50 per month, attempting to justify it by stating that "[t]he 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."[124] The customer-related costs at equalized proposed return, shows the minimum customer-related cost, maximum customer-related cost, and average customer related cost for residential sales, respectively, as

[122] *Id.* at 50. This calculation used direct O&M expense, excluding allocations from Divisions 002 and 012, to ensure there was no circularity.
[123] Case No. 2017-00349, Final Order dated May 3, 2018, at 32-33.
[124] Direct testimony of Paul H. Raab, at 20.

$17.48, $27.02, and $20.66.[125] In Case No. 2017-00349, the same portion of the Company's COSS lists those same costs, respectively, as $17.86, $26.09, and 20.61.[126] While the maximum customer-related costs for residential customers and the average have ticked up slightly, the minimum costs to serve have gone down, below the current customer charge of $17.50. The Commission's reasoning in keeping the customer charge steady before, still holds true in this case today. Based on the results of the Company's COSS, the Commission should again find that the current customer charge is reasonable and should not be increased.

III. CONCLUSION

For any adjustments the Attorney General did not specifically discuss herein, he supports the recommendations put forward by his witness Mr. Kollen. Furthermore, the Attorney General would welcome any other adjustments the Commission may deem necessary and reasonable in this matter. With Atmos' spending spree in full force, customers can use any relief available to them to help ensure their rates are fair, just and reasonable.

WHEREFORE, the Attorney General respectfully requests that the Commission deny the rates Atmos requests, reduce Atmos' rates by the adjustments discussed above, deny the proposed increase in the residential customer charge, and grant all further relief as set forth in this brief.

[125] Raab direct, Exhibit PHR-5, p. 2.
[126] Case No. 2017-00349, Raab direct testimony, Exhibit PHR-5, p. 2.

Respectfully submitted,

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Certificate of Service and Filing

Counsel certifies that the foregoing is a true and accurate copy of the same document being filed in paper medium with the Commission within two business days; that the electronic filing has been transmitted to the Commission on April 23, 2019; that there are currently no parties that the Commission has excused from participation by electronic means in this proceeding.

This 23rd day of April, 2019.

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Assistant Attorney General

Attorney General's Brief Exhibit 1

Company	Company Name	Business Segment	Utility Account	Ferc Activity Code	Month Number	Project Number	Afudc Debt
010	Atmos Reg Shared Service	012 - Call Center Division	39903	Addition	201305	010.11773	552.56
010	Atmos Reg Shared Service	012 - Call Center Division	39908	Addition	201305	010.11773	1,354,318.64
010	Atmos Reg Shared Service	012 - Call Center Division	39902	Addition	201305	010.11773	7,704.03
010	Atmos Reg Shared Service	012 - Call Center Division	39100	Addition	201305	010.11773	2,470.36
010	Atmos Reg Shared Service	012 - Call Center Division	39901	Addition	201305	010.11773	114,175.43
010	Atmos Reg Shared Service	012 - Call Center Division	39100	Addition	201305	010.11773	88.94
010	Atmos Reg Shared Service	012 - Call Center Division	39908	Retirement	201507	010.11773	(5,417.27)
010	Atmos Reg Shared Service	002 - Dallas Atmos Rate Division	39931	Addition	201609	010.20687	1,893.35
010	Atmos Reg Shared Service	002 - Dallas Atmos Rate Division	39932	Addition	201609	010.20687	2,385.94
010	Atmos Reg Shared Service	002 - Dallas Atmos Rate Division	39938	Addition	201609	010.20687	149,652.15

Additions Less Retirements	
Division 12 Total	1,473,892.69
Allocation % to KY Division - Staff 2-64 Allocation Percentage	5.64%
	83,127.55
Division 02 Total	153,931.44
Allocation % to KY Division - Staff 2-64 Allocation Percentage	5.18%
	7,973.65
Division 009 Additions - Total	2,108,327.43
Division 009 Retirements - Total	(86,837.02)
Net Division 009 - Total	2,021,490.41
Total of Direct and Allocated Net AFUDC to KY Division	2,112,591.61
Grossed Up Rate of Return Recommended by AG	8.90%
Revenue Requirement Related to Net AFUDC Recorded - Return On	188,097.43
Average ALG Depreciation Rate Per Company ALG Computation	3.20%
Depreciation Expense Related to AFUDC in Test Year	67,602.93
Revenue Requirement Related to Net AFUDC Recorded - Return On and Of	255,700.36