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February 18, 2022

Linda C. Bridwell  
Executive Director  
Public Service Commission  
211 Sower Blvd.  
Frankfort, KY 40601

Re: Atmos Energy Corporation  
Case No. 2020-00289

Dear Ms. Bridwell:

Atmos Energy Corporation submits its post hearing brief.

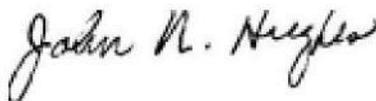
I certify that the electronic documents are true and correct copies of the original documents and that no party has been excused from electronic service.

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

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Attorneys for Atmos Energy Corporation

**BEFORE THE PUBLIC SERVICE COMMISSION**

**COMMONWEALTH OF KENTUCKY**

**ELECTRONIC REQUEST OF ATMOS ENERGY )**  
**FOR MODIFICATION AND EXTENSION OF ITS )** **CASE NO. 2020-00289**  
**GAS COST ADJUSTMENT PERFORMANCE BASED)**  
**RATEMAKING MECHANISM )**

**INITIAL POST-HEARING BRIEF OF ATMOS ENERGY CORPORATION**

**A. History of Proceeding**

On August 31, 2020, Atmos Energy Corporation (“Atmos Energy” or “Company”) filed a motion (“Aug. 31 Motion”) to modify and extend its existing Performance Based Ratemaking Mechanism (“PBR Mechanism”) along with its report of the performance of its PBR Mechanism from June 2016 through May 2020 (“PBR Report”). At the time that Atmos Energy filed the Aug. 31 Motion, it had no way of knowing that the Kentucky Public Service Commission (“Commission”) would issue an order on October 26, 2020 in Case No. 2019-00437, a Louisville Gas and Electric proceeding, that would signal the Commission’s intent to take “consistent action with regard to gas cost PBR Mechanisms for the three local distribution companies.”<sup>1</sup> Since Atmos Energy was not aware of the Commission’s intent at the time it filed the Aug. 31 Motion, it did not have the opportunity to file Direct Testimony on the specific issues listed by the Commission in its Order issued on October 26, 2020 in Case No. 2019-00437.

The Commission Staff and the Attorney General of the Commonwealth of Kentucky, by and through the Office of Rate Intervention (“Attorney General”) each propounded two sets of discovery questions on Atmos Energy. The Company timely filed its responses to discovery,

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<sup>1</sup> See Order dated October 26, 2020 in Case No. 2019-00437, *Electronic Application of Louisville Gas and Electric Company for Renewal and Proposed Modification of its Performance-Based Ratemaking Mechanism* (“LG&E Order”) at p. 9.

explaining that the current PBR Mechanism strikes the right balance to incentivize the Company to take on appropriate risk and generate savings to reduce costs for customers. Given the lack of Direct Testimony, there was no Answering Testimony or Rebuttal Testimony filed in this Case. The only record evidence in this proceeding is the Company's Aug. 31 Motion, the PBR Report, and the Company's filed responses to discovery.

On March 22, 2021, the Commission granted a joint motion of Atmos Energy and the Attorney General regarding submission of the case and a motion to file briefs ("March 22 Order"). The March 22 Order also stated that the Commission "may take additional evidence in this matter through written requests for information or at a hearing set pursuant to a subsequent order." Briefs were filed by the Company and the Attorney General on March 25, 2021.

On December 17, 2021, the Commission issued an Order ("December 17 Order") requiring Atmos Energy to respond to a third set of data requests by January 14, 2022,<sup>2</sup> and establishing a hearing to be held virtually on January 27, 2022 ("Hearing"). Atmos Energy provided proper notice of the January 27, 2022, hearing through publication. Witnesses for the Company provided direct testimony at the Hearing. Post hearing data requests were propounded by Commission Staff on February 2, 2022, and the Company filed its responses on February 16, 2022.

### **B. PBR Mechanism<sup>3</sup>**

The actual PBR Mechanism is fully explained in the Company's Tariff and extensively summarized in the Company's initial brief in this proceeding filed March 25, 2021. For the sake of brevity, the Company will refrain from repeating those details here. At a high level, the PBR Mechanism consists of three distinct components: (1) commodity costs (GAIF); (2) transportation costs (TIF); and (3) off-system sales transactions (OSSIF). The PBR Mechanism functions by

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<sup>2</sup> Atmos Energy filed timely responses to the Staff's third set of Data Requests.

<sup>3</sup> Capitalized terms not defined herein have the same meanings as in the Atmos Energy Tariff.

benchmarking commodity costs and transportation costs, and then allocating the differences between actual costs and the benchmarks between the Company and its customers.

**a. PBR Mechanism Components**

The Gas Commodity Cost and Transportation Cost components of the PBR Mechanism received the most attention at the Hearing.<sup>4</sup> They are components through which the Company currently achieves savings for its customers. Atmos Energy contends that the Off-system Sales component should be retained because Off-system Sales and Capacity Releases are activities that occur in response to market forces, and it would not be practical or even possible to request regulatory approval to reinstitute those mechanisms.<sup>5</sup> Further, it is important that the PBR Mechanism encompasses all forms of upstream costs and savings, as all dollars saved are equally valuable to customers and the failure to consider all costs and savings holistically could result in driving savings to areas that are shared and costs to areas that are not shared as part of the PBR Mechanism.

**b. Gas Commodity Cost Component**

The Gas Commodity Cost Component currently benchmarks the Company's gas purchases against pipeline-specific indices. For baseload (first-of-the-month) purchases, the benchmark is a simple 50/50 average of the NYMEX price and an iFERC index price for the specific pipeline on which the Company elects to purchase gas. For day-ahead purchases, the benchmark is a Gas Daily index price for the specific pipeline on which the Company elects to purchase gas. The five supply areas are TGT-1 (Texas Gas Transmission Zone 1), TGPL-500 (Tennessee Gas Pipeline-Louisiana 500), TGC-LA (Trunkline Gas Company Louisiana), ANR-LA (ANR Louisiana), and ANR-HH (ANR-

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<sup>4</sup> As noted in its response to AG DR 2-05 and its prior Brief in this proceeding, The Company has not recently made regular use of the PBR Mechanism's Off-System Sales component.

<sup>5</sup> Response to Staff DR No. 1-02.

South Louisiana, Henry Hub).<sup>6</sup> It is the Company's contention that these locations are appropriate for setting the benchmarks because they reflect where the Company would likely purchase gas on those pipelines.

At the hearing, there was discussion regarding the fact that some of the Company's primary transportation contract receipt point entitlements are at different locations than the indices which are used to calculate the benchmark.<sup>7</sup> However, as Company witness Buchanan articulated, the receipt point entitlements the Company holds are to meet design day demand, and not reflective of where the Company normally purchases gas. Obviously, most days are not design days.

Regarding the use of the NYMEX price as a component of baseload purchases – it is a Henry Hub based price. Many of the Company's purchases and contract entitlements are located at and around the Henry Hub. The Company believes that the use of the NYMEX price as a component of baseload purchases is appropriate because it is an extremely liquid trading hub and is connected to several pipelines, including Texas Gas Transmission and Trunkline, which provide the majority of the upstream capacity for the Company in Kentucky.

To the extent that an asset manager is offering a discount on commodity pricing because of value that it can derive from released capacity, it is true that this would be reflected as a savings under the Gas Commodity Cost Component, however, this would reduce the optimization credit that the asset manager would offer for the right to use Atmos Energy's capacity.<sup>8</sup> As the Vice-Chair noted, the Company has consistently achieved savings under the benchmark Gas Commodity Cost Component.<sup>9</sup> However, as Company witness Buchanan testified, the Company's ability to

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<sup>6</sup> ANR uses a different index price depending upon which location the Company elects to make its purchases from the Asset Manager.

<sup>7</sup> Hearing Video at approximately 10:30 AM

<sup>8</sup> Hearing Video at approximately 10:21 AM

<sup>9</sup> Hearing Video at approximately 11:00 AM

beat the benchmark price with that degree of reliability is only possible due to the asset manager's capacity utilization credits being applied against gas costs.<sup>10</sup> Furthermore, as Company Witness Buchanan testified, the contract pricing is only available to the Company as a function of its complex long-term asset management arrangements.<sup>11</sup> It could not consistently achieve comparable pricing as a regular market participant.

Regarding the Company's portfolio and its adequacy to meet customer's needs, the Company illustrated in its response to Staff's Post-Hearing Data Response 1-06 that it holds a reasonable reserve margin to serve its customers. A reserve margin of zero is obviously insufficient, as the Company's recent experience in other jurisdictions during Winter Storm Uri had it exceeding its calculated design day.

### **c. Transportation Cost Component**

The Transportation Cost Component currently benchmarks actual transportation charges incurred against the Tariffed Pipeline Commodity Rate for each pipeline on which the Company holds capacity. The Company contends that this is the appropriate calculation for the Transportation Cost Component because it accurately reflects savings achieved against the just and reasonable cost-of-service based rates for that pipeline capacity as set by FERC. Also, incentivizing the Company to take on commodity price risks to achieve savings under the Transportation Cost Component has historically created benefits for customers, as shown by the past performance of the PBR Mechanism.

As Company explained, the segmentation of pipeline capacity results in taking on greater price risk.<sup>12</sup> It is true that segmentation of pipeline capacity will almost certainly result in a savings

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<sup>10</sup> Hearing Video at approximately 11:11 AM

<sup>11</sup> *Id.*

<sup>12</sup> Response to Staff DR No. 1-03.

being realized in the Transportation Cost Component of the PBR Mechanism, since it is hard to envision a scenario in which the Company would pay equal to or in excess of the Tariffed Pipeline Commodity Rate for segmented capacity.<sup>13</sup> However, in order to achieve the savings that come with segmented capacity, the Company must accept price risk associated with that segmented release via the PBR Mechanism's Gas Commodity Cost Component. This helps illustrate why it is imperative that a PBR Mechanism encompass all aspects of upstream gas costs. A utility will only be willing to accept increased risk in one component if it can benefit from reduced risk in another.

When evaluating potential pipeline transportation contracts, the Gas Supply Planning Department must balance the potential tradeoff in enhanced Asset Management value with the liquidity and pricing of gas supply at various receipt points.<sup>14</sup> In the absence of the PBR Mechanism, there would be no balancing of risks to perform. The Gas Supply Planning Department would select receipt points in accordance with the "least cost acquisition" standard, based on cost and reliability.<sup>15</sup>

The current PBR Mechanism strikes the right balance to incentivize the Company to take on price risk and generate greater savings.<sup>16</sup> The PBR Mechanism's historical performance demonstrates that it effectively incentivizes the Company to continuously seek savings and reduce costs.<sup>17</sup>

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<sup>13</sup> Although unlikely, if a pipeline was fully subscribed or if needed capacity was otherwise unavailable, a segmented capacity release could be worth equal to or in excess of the tariff rate.

<sup>14</sup> Response to Staff DR No. 1-04.

<sup>15</sup> Response to Staff DR No. 1-06.

<sup>16</sup> Response to AG DR No. 1-24.

<sup>17</sup> Response to Staff DR No. 2-02.

### **C. PBR Mechanism Performance**

Given its lengthy 22-year history, it is easy to “cherry-pick” moments when the PBR Mechanism generated lesser or greater savings than it does at the current time. Similarly, it is easy to single out individual parts of the PBR Mechanism as “better” or “worse” today than they were at some point in the past.<sup>18</sup> While the gas and transportation markets will continue to change over time, the PBR Mechanism still works, as evidenced by measurable savings totaling \$28,000,000 over the four-year period of June 2016 through May 2020, with the majority of those savings going to customers.<sup>19</sup> Since its inception, the PBR Mechanism has generated savings of approximately \$112,000,000.<sup>20</sup>

### **D. Duration of PBR Mechanisms**

The Company would like to stress the long-term nature of transportation and supply contracts. While the Commission may make prospective changes to the PBR Mechanism, utilities need long-term certainty to enable them to make intelligent decisions pursuant to PBR Mechanisms. To the extent that the Commission makes changes to the PBR Mechanism, the Company asks that, consistent with the Commission’s past practice, it do so for a five-year term. When entering into multi-year transportation and supply arrangements and balancing the adjusted risks under a PBR Mechanism, a utility must be able to rely on the parameters of a PBR Mechanism for the duration of those contract decisions.

As Company explained, its current contracts expire on March 31, 2023, and October 31, 2023.<sup>21</sup> While the Company recognizes the Commission’s ability to make prospective changes,

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<sup>18</sup> Response to AG DR No. 2-06.

<sup>19</sup> PBR Report at 7.

<sup>20</sup> At the time of the Aug. 31, 2020 filing, the PBR Mechanism had generated savings of approximately \$104,000,000 through May 31, 2020. The \$112,000,000 number reflects savings through May 31, 2021.

<sup>21</sup> Response to Staff DR No. 3-05.

for the duration of its current contracts, the Company is “locked in” to those terms and pricing. It is also important to note that the Company can often achieve better terms under a long-term contract than it can under shorter term contracts, the benefits of which primarily flow through to its customers.

#### **E. Conclusion**

It is inarguable that the PBR Mechanism has generated savings against the benchmark targets set by the Commission since its inception.<sup>22</sup> While the PBR Mechanism has changed over time and the natural gas transportation and supply markets have continued to evolve, the underlying principle of the PBR Mechanism has remained unchanged: Establish a benchmark for what the reasonable costs of upstream gas supply should be and incentivize the Company to achieve a savings. The flip side of the PBR Mechanism is that the application of strict benchmarks puts the Company at risk for costs that may otherwise be deemed prudently incurred and fully recoverable.

Atmos Energy has previously stated that that if an external event occurs, such as an Order or rulemaking of the FERC, which clearly and uncontrollably affects the benchmarks or some other aspect of the PBR Mechanism, Atmos Energy and the Commission should reserve the right to modify or terminate the program.<sup>23</sup> Atmos Energy still considers this an important consideration for the PBR Mechanism, as absent such a safeguard, the PBR Mechanism could result in unwarranted long-term windfall gains to the Company or to customers.

The Company asks the Commission to rule upon its request from its Aug. 31 Motion and renew its PBR Mechanism for a period of five years through May 31, 2026. However, given the time that has already elapsed, a longer extension may be warranted.

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<sup>22</sup> *Supra* note 20.

<sup>23</sup> PBR Report at 8.