COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF ATMOS ENERGY CORPORATION FOR AN ADJUSTMENT OF RATES	)))	CASE NO. 2021-00214

ATTORNEY GENERAL'S RESPONSES TO DATA REQUESTS OF THE KENTUCKY PUBLIC SERVICE COMMISSION STAFF

The intervenor, the Attorney General of the Commonwealth of Kentucky, through his Office of Rate Intervention ("AG"), submits the following responses to data requests of the Kentucky Public Service Commission Staff in the above-styled matter.

Respectfully submitted,

DANIEL CAMERON
ATTORNEY GENERAL

____
LAWRENCE W. COOK
J. MICHAEL WEST
ANGELA M. GOAD
JOHN G. HORNE II
ASSISTANT ATTORNEYS GENERAL
1024 CAPITAL CENTER DR., STE. 200
FRANKFORT, KY 40601
(502) 696-5453
FAX: (502) 564-2698
Larry.Cook@ky.gov
Michael.West@ky.gov
Angela.Goad@ky.gov
John.Horne@ky.gov

Certificate of Service and Filing

Pursuant to the Commission's Orders in Case No. 2020-00085, and in accord with all other applicable law, Counsel certifies that an electronic copy of the forgoing was served and filed by e-mail to the parties of record. Counsel further certifies that the responses set forth herein are true and accurate to the best of their knowledge, information, and belief formed after a reasonable inquiry.

This 4th day of November, 2021

____

Assistant Attorney General

AFFIDAVIT

STATE OF GEORGIA)

COUNTY OF FULTON)

LANE KOLLEN, being duly sworn, deposes and states: that the attached is his sworn testimony and that the statements contained are true and correct to the best of his knowledge, information and belief.

Lane Kollen

Sworn to and subscribed before me on this
4th day of November 2021.

Notary Public

RANDY A FUTRAL
MY COMMISSION EXPIRES
NOTARY
PUBLIC
AUGUST 26, 2024
COBB COUNTY, GEORGIA

AFFIDAVIT

STATE OF GEORGIA)

COUNTY OF FULTON)

RICHARD A. BAUDINO, being duly sworn, deposes and states: that the attached is his sworn testimony and that the statements contained are true and correct to the best of his knowledge, information and belief.

Richard A. Baudino

Sworn to and subscribed before me on this
4th day of November 2021.

Notary Public

RANDY A FUTRAL
MY COMMISSION EXPIRES
NOTARY
PUBLIC
AUGUST 26, 2024
COBB COUNTY, GEORGIA

WITNESS / RESPONDENT RESPONSIBLE:
LANE KOLLEN

QUESTION No. 1
Page 1 of 1

Refer to the Direct Testimony of Lane Kollen (Kollen Testimony), page 12, lines 10–15. Explain why these periods are an appropriate comparison given the seasonal nature of gas sales and resulting taxable income.

RESPONSE:

Atmos refused to provide its budget and/or forecast information for the tax year ending September 30, 2021 or for calendar year 2021 in response to AG discovery, claiming that it does not separate its budget and/or forecast taxable income between utility and nonregulated because it isn't required for external financial reporting purposes, including the IRS.[1] Yet, the asset NOL ADIT is based on a calculation of utility and nonregulated taxable income for ratemaking purposes. As Mr. Kollen noted in his direct testimony, it is the Company's burden to prove that the asset NOL ADIT is reasonable. Yet, it has not done so, as Mr. Kollen demonstrated in his direct testimony. Given the Company's failure to prove that the asset NOL ADIT is reasonable, the Commission could reject any asset NOL ADIT in rate base. Nevertheless, in an attempt to calculate a reasonable amount for ratemaking purposes, Mr. Kollen extrapolated the most recent actual information that was available. Atmos adjusts its asset NOL ADIT each quarter based on its estimated taxable income for the tax year. Atmos is required to make these calculations and remit one quarter of its estimated taxes payable based on its estimated taxable income for the tax year. Mr. Kollen does not believe that this calculation is based on quarterly taxable income, except to the extent that actual quarterly taxable income results in a modification to the annual estimated taxable income. The general rule is that Atmos must pay 25% of its "required annual payment" in four equal installments on April 15, June 15, September 15, and December 15. Alternatively, a corporation may use an "adjusted seasonal installment" as its estimated tax installment if it is less than the required installment or the annualized income installment, but only if the corporation's "base period percentage" for any six consecutive months of the tax year is at least 70%. Given these rules, Mr. Kollen believes that the quarterly reductions in the asset NOL ADIT from October 1, 2020 through March 31, 2021 were either 25% of the AEC estimated annual payment or less if the Company met the requirements for an "adjusted seasonal installment" and that his extrapolation of these quarterly results for April 1, 2021 through December 31, 2021 is reasonable.

[1] Response to AG 2-18.

WITNESS / RESPONDENT RESPONSIBLE:
LANE KOLLEN

QUESTION No. 2
Page 1 of 1

Refer to the Kollen Testimony, page 26, lines 15–24. Provide the adjustment necessary to remove non-cash items from the lead/lag study.

RESPONSE:

The reduction to rate base is $6.314 million. The reduction to the revenue requirement is $0.612 million using the grossed-up rate of return after Mr. Baudino's and Mr. Kollen's adjustments to the cost of capital. These reductions are incremental to Mr. Kollen's adjustment to CWC to reflect the depreciation expense lag days as described in his direct testimony. The calculations are provided in the attached Excel workbook in live format with all formulas intact.

WITNESS / RESPONDENT RESPONSIBLE:
LANE KOLLEN

QUESTION No. 3
Page 1 of 1

Refer to the Kollen Testimony, page 38, lines 4–8. Provide support for the conclusion that a reasonable level of short-term debt is approximately 2.0 percent of Atmos Energy Corporation's total capitalization.

RESPONSE:

The 2.0% is consistent with the lower end to midpoint of the range for short term debt that Mr. Kollen has observed in other recent utility base rate case proceedings. For example, in the pending Duke Energy Kentucky base rate case proceeding, Case No. 2021-00190, the Company requested a 2.6% short-term debt ratio. The settlement between Duke and the AG in that proceeding reflects a 2.6% short-term debt ratio. In the most recent KU and LG&E base rate case proceedings, Case Nos. 2020-00349 and 2020-00350, KU requested a 1.7% short-term debt ratio and LG&E requested a 1.3% short-term debt ratio. In the most recent Columbia Gas base rate case proceeding, Case No. 2021-00183, it requested a 3.1% short-term debt ratio. The 2.0% represents approximately $240 million in short-term debt, which is only 12.0% of the $2,000 million credit facility that Atmos maintains and for which it recovers the commitment fees.

WITNESS / RESPONDENT RESPONSIBLE:
LANE KOLLEN

QUESTION No. 4
Page 1 of 2

Refer to the Kollen Testimony, page 38, lines 12–20.

a. Provide support for the recommendation to phase in the short-term debt ratio over two base rate cases.
b. Explain whether or not a phase in of more than two base rate cases is recommended.
c. Explain whether or not commitment fees are traditionally excluded from the cost of debt calculation.

RESPONSE:

a. The Atmos-requested capital structure reflects an extremely excessive amount of common equity, which unnecessarily increases the revenue requirement for ratemaking purposes. Mr. Kollen recognizes that Atmos has deliberately increased its actual common equity ratio over the last several years, which ultimately drives up its top line (revenues) and its bottom line (earnings) to the extent the excessive equity ratio is reflected in rates. Mr. Kollen believes that the Commission should set the capital structure and the rate of return at reasonable levels, but he also recognizes that the reduction in the common equity ratio from 57.1% to the 50.3% average for the comparative group used by the Company's witness and Mr. Baudino as a proxy in the return on equity analyses may be too significant to achieve in a single rate case proceeding. Mr. Baudino recommended a two-step reduction in the common equity ratio, first to 53.5%, and then to 50.3%. Similarly, Mr. Kollen recommended a two-step increase in the short-term and long-term debt ratios to offset the reductions in the common equity ratio.

b. No. Mr. Kollen's recommendation is already a concession in recognition of the magnitude of the excessive common equity ratio. There typically is a period of 2 or 3 years between the Company's base rate cases. Atmos could use the 2 or 3 years between this proceeding and its next proceeding to modify its actual outstanding equity and debt to more closely conform it to the Commission's determination of a reasonable capital structure so that its revenues based on that reasonable capital structure and its actual capital structure more closely match. If it does not do so, then it will underearn its authorized return based on its own decision to maintain an excessive common equity ratio.

   The Commission recently approved Atmos' request for authority to issue $5,000 million in future equity and debt financing in Case No. 2021-00193. In its Application in that proceeding, Atmos indicated its intent to issue "up to $2,250 million in common equity and up to $2,750,000,000 in long-term debt securities,"[2] or 45% in common equity and 55% in long-term debt. If Atmos does so, then this will result in a lower common equity and greater long-term debt ratio, which would be more consistent with Mr. Baudino's and my recommendations in this proceeding.

c. Mr. Kollen has seen both approaches used for ratemaking. If excluded from the cost of debt calculation, then the fees would be included in operating expenses as a fixed expense, which is consistent with the nature of the fees, rather than as a variable expense, which could incorrectly increase the interest expense included in the revenue requirement if the Commission increases the short-term debt in the capital structure. This is particularly a concern with Atmos in this rate case proceeding because Atmos forecasts almost no short term debt in the test year; consequently, including the commitment fees results in a 25.17% cost of short-term debt. To address this problem in conjunction with his recommendation to reduce the common equity ratio and increase the long-term debt and short-term debt ratios, Mr. Kollen recalculated the cost of short-term debt, first to 4.93%, assuming that the entirety of the Company's forecast commitment remained in the cost of short-term debt, and then reduced it further to 2.57% to reflect the reduction in the commitment fees based on the Company's response to AG discovery on the issue. These calculations are detailed in the "COC" tab in Mr. Kollen's electronic workpapers filed with the Commission at the same time his testimony was filed.

[2] Commission Order approving Atmos' request in Case No. 2021-00193.

WITNESS / RESPONDENT RESPONSIBLE:
LANE KOLLEN

QUESTION No. 5
Page 1 of 1

Refer to the Kollen Testimony, page 39, lines 11–12. Provide support that using the most recent cost of new long-term debt is preferred to the cost of the long term debt at the conclusion of the case record.

RESPONSE:

Mr. Kollen recommends that the Commission use the cost of new debt using current interest rates for the incremental long-term debt in conjunction with his recommendation to reduce the common equity ratio and increase the long-term debt and short-term debt ratios. It would not be appropriate to use the average cost of debt for two reasons. First, the average cost of debt reflects all outstanding debt, not just the incremental cost of the incremental debt. Second, the average cost of debt would not include the cost of additional debt issuances if, in fact, Atmos did not issue that debt on or before the conclusion of the case record, which it would be unlikely to do given its position on the capital structure in this case.

WITNESS / RESPONDENT RESPONSIBLE:
LANE KOLLEN

QUESTION No. 6
Page 1 of 1

Refer to the Kollen Testimony, page 40, lines 17–22 and page 41, lines 1–17. Also refer to page 38 of Mr. Kollen's testimony, lines 18–20. Explain why Mr. Kollen is recommending reducing the commitment fees included in the cost of short-term debt, but proposes to remove the entirety of the commitment fees for the cost of the proposed additional short term debt ratio.

RESPONSE:

Mr. Kollen included the commitment fees in both of his recalculations of the short-term debt interest rate for both of his recommendations. These calculations are shown on the "COC" tab in his electronic workpapers.

WITNESS / RESPONDENT RESPONSIBLE:
RICHARD A. BAUDINO

QUESTION No. 7
Page 1 of 2

Refer to the Direct Testimony of Richard Baudino (Baudino Testimony) generally.

a. Provide Exhibits RAB-2-5 in Excel format with all formulas, columns, and rows unprotected and fully accessible.

b. For each of the return on equity (ROE) methods employed, provide a separate discussion of the assumptions required and why each assumption can reasonably be assumed. If assumptions cannot be reasonably assumed, explain why not.

RESPONSE:

a. Please refer to the attached spreadsheet entitled "Atmos Gas 2021 ROE.xlsx".

b. Mr. Baudino provided a general explanation of the assumptions for the constant growth version of the Discounted Cash Flow ("DCF") model on pages 16 through 17 of his Direct Testimony. One additional assumption of this model is that dividends, earnings, and book value all grow at the same rate over time. In his book New Regulatory Finance, page 252, Dr. Roger Morin presented four crucial assumptions embodied in the General DCF model as follows:

1. Investors evaluate common stocks in the classical valuation framework and trade securities rationally at prices reflecting their perceptions of value.
2. Investors discount the expected cash flows at the same rate, K, in every future period.
3. The discount rate, K, obtained from the fundamental DCF equation corresponds to the specific stream of future cash flows alone, and no other.
4. Dividends, rather than earnings, constitute the source of value to the investor.

Dr. Morin also listed additional assumptions for the standard DCF model as follows on pages 255 - 258:

1. The discount rate, K, must exceed the growth rate, g.
2. The dividend growth rate is constant in every year to infinity.
3. Investors require the same return, K, every year.
4. No external financing.

Mr. Baudino also provided an overview of the Capital Asset Pricing Model ("CAPM") foundation and assumptions on pages 21 through 22 of his Direct Testimony, as well as an explanation of some of the model's shortcomings on pages 23 through 24.

On pages 147 - 148 of New Regulatory Finance, Dr. Morin noted that the CAPM has two general assumptions that, in his view, overshadow the others:

1. Capital markets are competitive and efficient, and information is freely available to all investors.
2. Investors are rational profit-maximizers who pursue their monetary self-interests and demand higher returns for higher risks.

Please refer to Chapter 5 and Appendix 5-A of New Regulatory Finance for a thorough discussion of the additional assumptions underlying the CAPM.

The assumptions underlying the DCF and CAPM support these models, which have been accepted in regulatory jurisdictions throughout the United States. Their assumptions are not always met in practice in the real world. Nonetheless, these models are still useful in attempting to estimate the investor required ROE. As Mr. Baudino also pointed out in his Direct Testimony, the CAPM has shortcomings that make it less reliable for estimating the investor required ROE.

WITNESS / RESPONDENT RESPONSIBLE:
RICHARD A. BAUDINO

QUESTION No. 8
Page 1 of 1

Refer to the Baudino Testimony, page 10, Table 1. Provide an update with the most recent data available.

RESPONSE:

Mr. Baudino does not have the September 2021 Mergent public utility bond yield. The 30-Year Treasury Bond yield for September 2021 was 1.94%.

WITNESS / RESPONDENT RESPONSIBLE:
RICHARD A. BAUDINO

QUESTION No. 9
Page 1 of 1

Refer to the Baudino Testimony, page 11, Figure 2. Provide an update with the most recent data available.

RESPONSE:

Mr. Baudino does not have the September 2021 Mergent average public utility bond yield and, thus, cannot update Figure 2.

WITNESS / RESPONDENT RESPONSIBLE:
RICHARD A. BAUDINO

QUESTION No. 10
Page 1 of 1

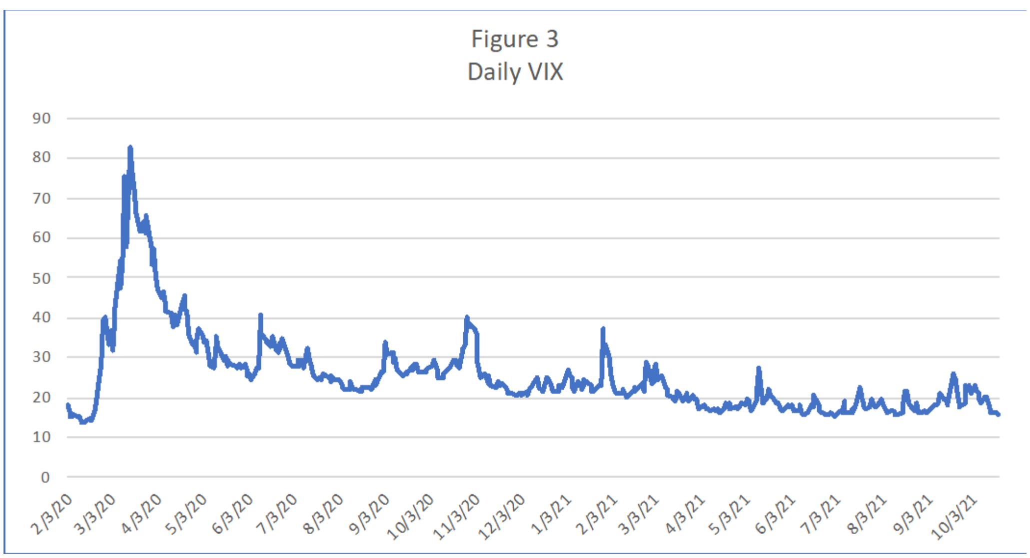
Refer to the Baudino Testimony, page 14, Figure 3. Provide an update with the most recent data available.

RESPONSE:

An updated Figure 3 is provided below, with data through October 20, 2021. Also, please refer to the attached Excel file entitled "Updated Figure 3.xlsx".

Please note that this update reflects the time that Mr. Baudino prepared the response to this data request. Daily updates to the VIX may be obtained from the CBOE using the following link:

https://www.cboe.com/tradable_products/vix/vix_historical_data/



WITNESS / RESPONDENT RESPONSIBLE:
RICHARD A. BAUDINO

QUESTION No. 11
Page 1 of 1

Refer to the Baudino Testimony, page 17, lines 14–18.

a. Explain whether a proxy group of seven regulated gas distribution utilities represents a large enough representative sample on which to derive statistically significant ROE estimates.

b. In addition to using gas utilities, explain whether using water utilities as additional proxy companies would be appropriate in the DCF and CAPM analyses and, if not, why not.

RESPONSE:

a. In this case, it is Mr. Baudino's conclusion that the proxy group of seven gas distribution companies represents a large enough sample to reasonably estimate the required ROE for the proxy group and for Atmos Energy Corp.

b. Mr. Baudino would not advise including water utilities in a proxy group of gas distribution companies given the different markets in which water utilities operate and the attendant different business risks faced by water utilities.

WITNESS / RESPONDENT RESPONSIBLE:
RICHARD A. BAUDINO

QUESTION No. 12
Page 1 of 1

Refer to the Baudino Testimony, page 17, lines 21–24. Explain why the most reasonable period over which to estimate dividend yields is six months.

RESPONSE:

Six months is a reasonable period over which to measure the current dividend yield for the proxy group. This length of time is not overly long compared to one year, in which stock prices earlier in the period may no longer reflect current investor requirements. However, six months is a reasonable period over which to smooth out any extreme fluctuations that may occur in stock prices, making shorter periods such as one or three months unreflective of longer term expectations of investors.

WITNESS / RESPONDENT RESPONSIBLE:
RICHARD A. BAUDINO

QUESTION No. 13
Page 1 of 1

Refer to the Baudino Testimony, page 25, lines 1–3. Explain why using an average of both the median and average values is better than relying on one or the other.

RESPONSE:

Both the median and the average annual return projections represent alternative measures of central tendency of Value Line's large data base of companies. Using both the average and the median values provides a reasonable range of possible values for investor expectations regarding the expected annual return on the market, rather than simply relying on one measure (either the average or the median).

WITNESS / RESPONDENT RESPONSIBLE:
RICHARD A. BAUDINO

QUESTION No. 14
Page 1 of 1

Refer to the Baudino Testimony, page 25, lines 19–22 and page 26 lines 1–5. Explain why the "historical risk premium of stock returns over the long term government bond returns has been significantly influenced upward by substantial growth in the price/earnings ("P/E") ratio" is important and why Duff and Phelps subtracted out the P/E ratio for stocks from the historical risk premium.

RESPONSE:

It is important to consider removal of the increase in the P/E ratio from historical risk premiums on the basis that continued expansion of the P/E ratio cannot be predicted to continue indefinitely. Duff and Phelps cited the work of Roger Ibbotson and Peng Chen in this area in the development and quantification of the supply-side equity risk premium.

WITNESS / RESPONDENT RESPONSIBLE:
RICHARD A. BAUDINO

QUESTION No. 15
Page 1 of 1

Refer to the Baudino Testimony, page 25, lines 13–18, and to page 26, lines 6–10. Explain the reasoning for using 20-year Treasury bonds to determine the historical MRP, but 30-year Treasury bonds were used as the risk free rate.

RESPONSE:

Duff and Phelps uses a 20-Year Treasury Bond, rather than the 30-Year Treasury Bond, in its analyses of annual total returns, income returns, and capital appreciation returns for its Basic U.S. Asset Classes, rather than the 30-Year Treasury Bond yield. However, there is very little difference in the yield between the 20-Year and 30-Year Treasury bond yields. For example, for September 2021 the 20-Year Treasury Bond yield was 1.87% and the 30-Year Treasury Bond yield was 1.94%, a difference of only 7 basis points.

WITNESS / RESPONDENT RESPONSIBLE:
RICHARD A. BAUDINO

QUESTION No. 16
Page 1 of 1

Refer to the Baudino Testimony, page 26, lines 12–15. Provide a greater explanation of Duff and Phelps' "normalized" risk free rate, and how it incorporates expected inflation.

RESPONSE:

The Duff and Phelps methodology considers a range of estimates for the long-term real risk free rate as well as a range of expected inflation forecasts. In a simple build-up method, the range of values for the long-term real risk-free rate is added to a range of inflation forecasts to obtain a range for the long-term normalized risk-free rate. Duff and Phelps' current recommended normalized risk-free rate of 2.5% is near the midpoint of the current range of estimates for the long-term normalized risk-free rate.

WITNESS / RESPONDENT RESPONSIBLE:
RICHARD A. BAUDINO

QUESTION No. 17
Page 1 of 1

Refer to the Baudino Testimony, page 29, Table 3. Provide an update of Table 3.

RESPONSE:

No further updates are available at this time. The next Value Line update of its natural gas utilities with occur approximately 3 months after the August 27, 2021 reports were published.

WITNESS / RESPONDENT RESPONSIBLE:
RICHARD A. BAUDINO

QUESTION No. 18
Page 1 of 1

Refer to the Baudino Testimony, Exhibit RAB-3, page 1 of 2. Comparing the projected EPS growth rates of Value Line, Zacks and Yahoo! Finance, several are close and others are very different, e.g. New Jersey Resources, South Jersey Industries, and Spire Inc. Explain the factors, if known, in Value Line's EPS analyses versus other analysts' projections that would lead to such divergent results for select companies only.

RESPONSE:

Mr. Baudino does not know the factors in Value Line's analyses and results that would lead to the significantly divergent results for the selected companies in the question. The Yahoo! Finance and Zacks earning growth estimates are consensus forecasts from more than one source, which is different from Value Line's earnings growth forecasts that are prepared by one analyst.

WITNESS / RESPONDENT RESPONSIBLE:
RICHARD A. BAUDINO

QUESTION No. 19
Page 1 of 1

Refer to the Baudino Testimony, Exhibit RAB-5, page 1 of 1. Provide an explanation for the column "Adjusted Arithmetic Mean."

RESPONSE:

The adjusted arithmetic mean is the supply-side equity risk premium discussed by Mr. Baudino on pages 26 through 27 of his Direct Testimony. This equity risk premium has the extra return from inflation in the P/E ratio removed.