COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF ATMOS ENERGY CORPORATION FOR AN ADJUSTMENT OF RATES; APPROVAL OF TARIFF REVISIONS; AND OTHER GENERAL RELIEF	))))	CASE NO. 2024-00276

ATTORNEY GENERAL'S POST-HEARING BRIEF

Respectfully submitted,

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The intervenor, the Attorney General of the Commonwealth of Kentucky, through his Office of Rate Intervention ("AG"), hereby submits his Final Brief in the above-styled matter.

I. STATEMENT OF THE CASE

On September 27, 2024 Atmos Energy Corporation ("Atmos," "AEC," or "the Company") tendered its application for an adjustment of rates. On that same date, the AG filed its motion to intervene, which the Kentucky Public Service Commission ("Commission") granted on October 3, 2024. The Commission accepted Atmos' Application for filing on October 11, 2024. Following the Commission's issuance of a procedural schedule on October 17, 2024, the AG and Commission Staff issued several rounds of data requests, to which Atmos filed responses into the record. On January 27, 2025, the AG filed the direct testimony and exhibits of his witnesses, Messrs. Lane Kollen, Randy A. Futral and Richard A. Baudino.[1] On February 24, 2025 the AG filed responses to data requests from Atmos and Commission Staff. Atmos filed its Rebuttal Testimony on March 10, 2025. On May 2, 2025,

[1] *NOTE*: Unless otherwise specified in this Brief, the AG agrees with all adjustments and recommendations of Messrs. Kollen, Futral and Baudino and recommends the Commission adopt such in their entirety. The AG's final revenue recommendations are reflected in Table 1 of the Futral Direct Testimony at p. 1.

the Commission held a public comment hearing in Owensboro. The evidentiary hearing in this matter was held from May 6 – May 7, 2025.

II. ARGUMENT

1. RATE BASE ISSUES

a. <u>Reduce Asset NOL ADIT to Reflect Updated Balances Through FYE 2024</u>

AEC is the parent company that files a consolidated tax return on behalf of the Atmos divisions and its subsidiaries.[2] Atmos is a division of AEC; it is not a separate legal entity and is not a separate subsidiary of AEC. Atmos included a $28.444 million Net Operating Loss Carryforward Deferred Tax Asset (NOLC DTA) as an addition to rate base in its application in the instant case. The NOLC DTA was calculated in four steps. In the first step, Atmos disaggregated AEC's total NOLC and NOLC DTA into three amounts: one for the AEC utility divisions, which includes the Atmos Kentucky division, the second for Atmos Energy Holdings, Inc. (AEHI), [3] and the third for "Other."[4, 5]

In the second step, Atmos allocated the AEC Utility NOLC DTA for all AEC utility divisions as of September 30, 2021 to the Kentucky division for ratemaking purposes using an AEC general (composite) factor. The AEC utility NOLC DTA on September 30, 2021

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[2] *See* Kollen Direct Testimony at 7-8, and his Ex. LK-2 (Response to AG-DR-1-33). The different Atmos divisions through which the Company operates in its jurisdictions are structured under AEC. *Id.*

[3] AEHI is the holding company for AEC's unregulated entities.

[4] In its response to AG-DR-1-34 (attached to Kollen Direct as Ex. LK-3), Atmos explained: "The NOL -Other is for GAAP purpose and it is to record the federal benefit of a state tax expense reserve due to uncertain tax position ("UTP"). This UTP is regarding Atmos Energy's operation in jurisdictions outside of Kentucky, and it is excluded from Kentucky filing."

[5] However, the AEC Utility NOLC and NOLC DTA are significantly larger than the AEC consolidated NOLC and NOLC DTA. *See* Kollen Direct at 8:1-7.

thus reflects all income and all deductions of all the AEC utility divisions regardless of the actual income and deductions of each division (except for the effects of Winter Storm Uri).[6]

In the third step, Atmos calculated the changes in the NOLC DTA for the Kentucky division on a standalone basis through June 30, 2024 in its Application, which it subsequently updated through September 30, 2024 in response to Staff discovery.[7] However, Atmos then assumed no change in the NOLC DTA from the April 1, 2025 start of the test year until its end on March 31, 2026, meaning that it assumed there was and will be no taxable income to reduce the NOLC and the NOL DTA during the six-month period between September 30, 2024 and March 31, 2025.[8]

In the fourth step, the Company calculated the taxable income and the reduction in the NOLC and NOLC DTA in the test year. Following the first three steps, the NOLC DTA was $34.259 million, and in the fourth step, the Company reduced the NOLC DTA by $5.815 million to yield the $28.444 million included in rate base.[9] However, Atmos' allocation of tax benefits generated by the AEC utilities to AEHI were retained by AEC, while each of AEC's utility divisions (including the Kentucky division) were allocated a hypothetical cost.[10] Instead, the AEC utility divisions should be allocated the actual tax benefits they generated.[11]

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[6] Kollen Direct at 8:14-16. Atmos claims that it lacks sufficient information to calculate the actual NOLCs and NOLC DTAs for each division, but acknowledged that it does have sufficient detailed information to calculate the actual NOLs and NOL DTAs for each division based on the historic tax depreciation deductions in excess of the book depreciation deductions for each division. *Id.* at 9 (*citing* the Response to AG-DR-1-40(e), attached to Kollen Direct as Ex. LK-4).
[7] Kollen Direct at 9.
[8] *Id.*
[9] *Id*. at 9:13-16 (*citing* Application Sch. B.5F).
[10] *Id*. at 9-10. As Mr. Kollen notes, the Commission should take this into consideration when considering his second, and especially his third adjustments to the NOLC DTA. *Id.* at 10:4-7.
[11] *Id*. at 9-10.

Atmos subsequently provided an update[12] that reduced the NOLC DTA as of September 30, 2024 based on the Kentucky Division's actual taxable income during the three month period June 2024 - September 2024. This update should be reflected as a reduction to Atmos' requested base revenue increase. The effect of this adjustment reduces rate base by $0.794 million, and reduces the requested base revenue increase by $0.085 million.[13] The Company agreed to this adjustment in its rebuttal testimony.[14]

Atmos' methodology also included an incorrect assumption[15] that the asset NOLC DTA will remain unchanged from September 30, 2024 through March 31, 2025.[16] In fact, the NOLC DTA should be further reduced due to taxable income during this six-month "bridge" period. The AG asked the Company in discovery to provide calculations of this amount, but it refused to do so.[17] The Company opposes an adjustment to reduce the NOLC DTA during this "bridge" period, despite the fact it affects the NOLC DTA that will be carried into the test year starting on April 1, 2025 and should be reflected in the rate base at a lower amount in the 13 month average for the test year. The Company's refusal in this regard is unreasonable, given that it bears the burden of proof regarding its forecast test year amounts.

b. <u>Reduce Asset NOL ADIT to Reflect Allocated Share of SSU Division Amount</u>

In the Company's last rate case, Case No. 2021-00214, the AG disputed the NOLC DTA amount included in rate base, based partly on the fact that the AEC Utility NOLC and NOLC DTA was the aggregate of all AEC utility divisions, not solely the Kentucky division.[18]

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[12] Response to Staff-DR-3-4.
[13] Kollen Direct at 10-11.
[14] Multer Rebuttal at 4:2-9.
[15] Kollen Direct at 12 (*citing* Response to AG-DR-1-40(e), attached to Kollen Direct as Ex. LK-4).
[16] *Id*. at 11.
[17] Response to AG-DR-1-40 (e) (attached to Kollen Direct as Ex. LK-4).
[18] *See, e.g., In Re*: Electronic Application of Atmos Energy Corp. for an Adjustment of Rates, Case No. 2021-00214, Direct Testimony of Lane Kollen at 7.

The Commission's final order in that case agreed with the AG's position:

> Thus, in light of the potentially significant losses being incurred by other divisions that might be assigned to Kentucky customers, the Commission finds that Atmos Kentucky's failure to identify and allocate NOLs to specific utility divisions is unreasonable going forward.
>
> Atmos Kentucky must now track the generation and utilization of NOL ADIT for Kentucky in each fiscal year on a standalone basis based on the expenses incurred and revenue generated from regulated operations in Kentucky, including any revenue from Atmos Kentucky's performance-based rates, without regard to losses incurred by other jurisdictions. In future applications to increase base rates, Atmos Kentucky must file a report showing the generation and utilization of NOL ADIT for Kentucky since this Order based on the expenses incurred and revenue generated from Kentucky operations. If Atmos Kentucky proposes to use a different method to reflect the generation and utilization of NOL ADIT for Kentucky in its revenue model in such cases, Atmos Kentucky must explain in detail why using that method would be reasonable.[19]

The Company failed to file the required report, and thus is in violation of a lawful Commission order. Instead, Atmos filed a new allocation methodology[20] with the application that actually increased the NOLC DTA in rate base, and increased the revenue requirement. This new methodology is not only unreasonable, but also introduces new problems by including the effects of all deductions for divisions 002 (Shared Services Unit), 012 (Customer Service), and 091 (Mid-States Corporate Office) even though many of those temporary differences are not recognized as expenses for ratemaking in Kentucky.[21] Moreover, the new Atmos methodology fails to include the taxable income and the reductions in the NOLC and NOLC DTA during the "bridge" period from July 1, 2024 through March 31, 2025 in its filing and from October 1, 2024 through March 31, 2025 in its updated response to Staff discovery.[22]

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[19] Case No. 2021-00214, Final Order Dated May 19, 2022 at 14.
[20] Kollen Direct at 11-13; *see also* Excel workbook KY_ADIT_-_EDIT_Tax_Update_June_2024.xls, filed with the application, and response to Staff-DR-3-4 update through Sept. 30, 2024.
[21] Kollen Direct at 12-13.
[22] Response to Staff-DR-3-4.

The Commission should adopt the methodology Mr. Kollen sets forth in his third NOLC adjustment.[23] The effect of this adjustment reduces rate base by $6.481 million, and the revenue requirement by $0.690 million.[24,25]

c. <u>Reduce Asset NOL ADIT to Reflect Only Book/Tax Depreciation Temporary Differences</u>

As Mr. Kollen explains, the only NOLC DTA that is required to be included in rate base to avoid a normalization violation is the portion caused by tax depreciation in excess of book depreciation in those tax years in which there was a taxable loss.[26] Mr. Kollen was able to calculate the maximum amount of the NOLC DTA caused by tax depreciation in excess of book depreciation at $15.272 million for the test year with the information provided by Atmos for the tax years covering the period January 1, 2022 through September 30, 2024. However, Atmos again refused to provide the historic information necessary to trace the tax depreciation in excess of book depreciation by tax year on a last dollar deducted methodology prior to 2022 that is necessary to calculate the lesser amount of the NOLC DTA.[27] Mr. Kollen's recommendations, explained in detail at pp. 17-20 of his Direct Testimony, are that the Commission should: (1) for this proceeding only, include only the portion of the NOLC DTA caused by tax depreciation in excess of book depreciation in rate base, which is the maximum amount that is required in order to avoid a normalization violation;[28] (2) direct the Company to provide the information necessary to calculate the minimum NOLC DTA

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[23] *Id*. at 13-14.
[24] *Id*. at 14.
[25] The Company conditionally agreed to this adjustment (Multer Rebuttal at 6:3-15), assuming the Commission does not approve Mr. Kollen's third NOLC adjustment, discussed *infra*.
[26] *Id*. at 16 (*citing* Case No. 2023-00231, *In Re*: Application of Atmos Energy Corporation For PRP Rider Rates Beginning October 1, 2023, Final Order dated Sept. 29, 2023 at 8).
[27] *Id*. at 16 (*citing* response to AG-DR-1-40 (e), attached to Kollen Direct as Ex. LK-4).
[28] *Id*. at 18.

necessary to avoid a normalization violation in its next base rate case filing;[29] and (3) direct the Company to include the "bridge" months in its NOLC and NOLC DTA calculations extending from the last month for which there is actual information in the base year through the last month in the forecast test year.[30] The effects of this adjustment are: (a) setting the adjusted NOLC DTA at $15.272 million, the maximum necessary to avoid a normalization violation; (b) an additional rate base reduction of $5.896 million; and (c) an additional base revenue reduction of $0.627 million.

d. <u>Subtract Vendor-Supplied Portion of Construction Expenditures</u>

Many investor-owned utilities, including Atmos, temporarily finance capital expenditures and operating expenses through delayed payments to vendors recorded as accounts payable.[31] Such vendor-supplied financing carries zero cost for the utility. In Atmos' last rate case, the Commission accepted the AG's recommendation to subtract construction accounts payable from rate base.[32] The effect of this adjustment reduces rate base by $5.312 million, and the revenue increase by $0.565 million.[33]

e. <u>Cash Working Capital Adjustment 1: Remove All Non-Cash Expenses</u>

Atmos' lead-lag study included cash working capital (CWC) in rate base of negative $2.2 million.[34] However, the Company's CWC calculations included the following non-cash expenses: (a) non-cash depreciation; (b) non-cash deferred income tax expense; and (c) non-

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[29] *Id*. Mr. Kollen elaborates that, "For this purpose, I recommend the Commission direct the Company to develop this information historically on a Kentucky division basis (as well as for the allocations from divisions 002, 012, and 091) starting in the first year there was an NOLC for the Kentucky division, assuming that tax depreciation in excess of book depreciation was the last dollar deduction in the Kentucky division taxable loss years, and assuming that the taxable income in each subsequent tax year is first used to reduce the NOLC for the tax depreciation in excess of book depreciation." *Id.* at 18:15-22.
[30] *Id*. at 18-19.
[31] Kollen Direct at 20.
[32] Case No. 2021-00214, Final Order dated May 19, 2022, at 17.
[33] *Id*. at 22.
[34] *Id*. at 22.

cash growth component of the return on equity (ROE) in the CWC calculations.[35] As Mr. Kollen explains:

> ". . . [T]he purpose of the lead/lag study and CWC calculations is to quantify the cash investment provided by either investors (positive) or customers (negative) on average for the delay in cash revenues to recover cash expenses incurred over the course of the lead/lag study period and the CWC calculations for the test year. The return on non-cash expenses, such as depreciation expense, is separately reflected in the return on balance sheet amounts included in rate base, such as plant in service less accumulated depreciation. There never will be a cash disbursement for depreciation expense. The cash disbursement on plant in service amounts was made when the construction cost was incurred and capitalized to construction work in progress or directly to plant in service."[36]

Furthermore, Mr. Kollen points out the fallacy in the Company's argument that depreciation expense should be included in the CWC calculation, allegedly because rate base is calculated at month end. Actually, rate base is calculated at the beginning of the month for 12 of the 13 months used in the 13-month average for rate base. The 13-month average for each component of rate base, including plant in service and accumulated depreciation, consists of 12 months of beginning balances, for the months of April 2025 through March 2026, and one month of ending balances, specifically for March 2026 only.[37]

Most importantly, the Commission has already decided this issue in Atmos last rate case. The Company used the exact same arguments in that case, but the Commission rejected them, stating: "Noncash expenses are not appropriate to include in the CWC determination. The Commission finds that noncash items should be removed from the lead/lag study."[38] The

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[35] *Id.* Mr. Kollen also explains that there are two components the ROE: (a) the dividend component, which is a cash expense and thus properly included in the CWC calculations; and (b) the non-dividend component, which reflects the growth component under the discounted cash flow formula historically relied on by the Commission. *Id*. at 25-26.
[36] *Id*. at 22-23.
[37] *Id*. at 24.
[38] Case No. 2021-00214, Final Order dated May 19, 2022, at 20.

effect of this adjustment reduces CWC included in rate base by $9.817 million and reduces the revenue increase by $1.045 million.[39]

f. Cash Working Capital Adjustment 2: Correct O&M, Non-Labor Expense Lag Days

Atmos' calculation of third-party vendor operations and maintenance (O&M) expense lag days included an error that understated the expense lag days.[40] The Company erroneously excluded the days from the end of the service period to the invoice date from the calculation of the expense lag days. This error understates the third-party vendor O&M expense days and overstates the CWC included in rate base.[41] Mr. Kollen recommends that the Commission correct the third-party vendor O&M expense lag days to 26.64 days from the 23.74 days as filed, an increase of 2.9 days.[42] The effect is to reduce rate base by $0.156 million, the requested revenue requirement by $0.017 million. Atmos agreed to this adjustment in its rebuttal.[43]

2. OPERATING INCOME ISSUES

a. Reduce Payroll Expense and Related Payroll Taxes Expense

Company witness Waller identified three O&M expense cost elements applicable to Atmos' employees: labor, benefits and employee welfare.[44] The testimony of AG witness Randy A. Futral summarizes the expenses for these three cost elements for the base year, the test year, and for each of the fiscal years 2022 through 2024.[45] The total cost for all three

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[39] *Id.* at 26-27.
[40] Kollen Direct at 27-28.
[41] *Id*. at 28. Mr. Kollen further explains that the Company's last rate case, Case No. 2021-00214, did not incorporate this error.
[42] *Id.*
[43] Christian rebuttal at 21:15-20.
[44] Direct Testimony of Gregory K. Waller, exhibit GWK-3 summarizes the Company's direct and allocated O&M expenses by these cost elements for the base year and the test year.
[45] Futral Direct, Table 2, at 7.

elements during the test year ($20.101 million) is 20.4% higher than actual expenses for FY 2024 ($16.7 million).[46]

Much of this increase is due to increased labor expense.[47] Projected test period labor expenses for the test period totals $14.070 million, compared to only $12.179 million for the 2024 fiscal year, an increase of approximately 15.5%.[48] These projected sums assume full budgeted staffing for the entire year, with no vacancies. The test period projects a total of 443,040 straight-time hours for Kentucky-based employees. However, a different picture emerges when contrasting actual straight time hours for 2021, 2022, and 2023: 399,843, 396,862, and 408,449, respectively.[49] Mr. Futral recommends that the Commission reduce test year labor expense because vacancies have been, and likely will continue recurring.[50] To accomplish this, Mr. Futral provided an escalation calculation of actual FY 2024 labor expense, upon which he based his recommendation to reduce payroll expense by $0.980 million, coupled with a corresponding $0.064 million reduction in payroll tax expense, totaling $1.044 million. [51] This results in a revenue requirement reduction of $1.056 million after being grossed-up for bad debt and Commission assessment fees.[52]

Atmos witness Waller asserted that $538,225 of increased test period payroll expenses is due to a labor capitalization rate variance for FY 2024.[53] Mr. Waller argued that it incurred a higher capitalization rate (59.7% actual in FY 2024) for Kentucky-direct employees, compared to a lower rate budgeted for the test year of 56.9% for FY 2025.[54] However, this

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[46] *Id*.
[47] *See Id*. at Table 2, p. 7.
[48] *Id.*
[49] *Id.* at 8 (*citing* Company Sch. G-2 at line 2).
[50] *Id.* at 8.
[51] *Id.* at 8-11. *See especially* Table 3 at 9.
[52] *Id.* at 10-11.
[53] Waller Rebuttal at 8.
[54] *Id*. at 8-9.

does not comport with the data recorded in Atmos Sch. G-2 filed with the Atmos application on September 27, 2024.[55] Schedule G depicts the Ratio of O&M expense labor dollars to total labor dollars for the period 2020-2023, together with the base period and the forecast period. Given that the O&M ratio fell within the approximate range of 40%-42%, this means, correspondingly, that the capitalization ratio for this same timeframe was actually between 58%-60%. Therefore, the test period capitalization rate for the test period is approximately identical with that for FY 2024, meaning there was no capitalization rate variance. The response to Staff's Post Hearing Data Requests provides additional insight during previous years showing that the actual capitalization rate was considerably higher than the budgeted capitalization rate for each of the years 2020 through 2023.[56] The budgeted and actual capitalization rates for Kentucky division employees only for those years are as follows:[57]

	Budgeted	Actual
2020	57.6%	60.1%
2021	57.6%	60.7%
2022	57.4%	60.2%
2023	57.9%	58.7%

a. Reduce Benefits Expense for Filing Error

In a discovery response, the Company acknowledged a filing error in the amount of Other than Pension Expense Benefits (OPEB) expense it seeks to recover. Mr. Futral's recommended adjustment to cure the error results in a reduction of $1.285 million in benefits

[55] This is also referred to as "FR 16(8)(g) Schedule G," and is accessible at: https://psc.ky.gov/pscecf/2024-00276/regulatory.support%40atmosenergy.com/09272024013751/FR_16%288%29%28g%29_Att1_-_Schedule_G.xlsx
[56] Atmos's response to Staff's PHDR 1-05.
[57] *Id.*

expenses, and $1.3 million in the revenue requirement after gross-up for bad debt and Commission assessment fees.[58] Atmos witness Waller agrees with this adjustment.[59]

b. <u>Reduce Ad Valorem Expense</u>

Atmos' projected ad valorem expense of $12.385 million was completely based on estimates. No portion of its calculations are based on actual ad valorem taxes paid or actual gross or net plant balances.[60] The Company's adjusted base period ad valorem expense of $11.983 million is much higher than the actual accruals being recorded starting in October 2024 for FY 2025.[61] The Company made two adjustments to the FY 2023 expense accrual amount: first, a decrease of $3.4 million due to a settlement with the Kentucky Department of Revenue applicable to tax years 2020-2022;[62] and second, an increase of $1.9 million to reflect a potential ad valorem tax increase.[63] Mr. Futral recommended that the Company provide support for its estimates and updates concerning valuation changes that were assumed in the base period ad valorem taxes used as a starting point to escalate amounts during the test year.[64] Mr. Futral also recommended that the ad valorem expense amount in the test year be reduced to $9.169 million, a reduction of $3.216 million compared to the Company's request.[65]

In its Rebuttal, Atmos modified this amount to $9.89 million, based on new data it had received at the end of 2024 from the Kentucky Department of Revenue and extrapolated

[58] Futral Direct at 11.
[59] Waller Rebuttal at 12:2-5.
[60] Futral Direct at 12-13.
[61] *Id*. at 13-14 (*citing* Responses to AG-DR-1-86 and AG-DR-2-4, attached to Futral Direct as Ex. RAF-5).
[62] *Id*. at 14 (*citing* Response to AG 2-03(a), attached to Futral Direct as Exhibit RAF-6).
[63] *Id*. The Company failed to provide any calculations or other information necessary to support this alleged increase.
[64] Futral Direct at 15.
[65] Futral Direct at 15.

to apply to all taxing jurisdictions.[66] Witness Waller's rebuttal position started with an ad valorem expense $9.085 million and escalated that amount to $9.39 million, based on the increase in plant through the end of the test year, and then added an upward adjustment of $500,000 related to a valuation methodology change for gas pipelines.[67] Atmos has offered no documentation supporting these calculations, nor the alleged change in valuation methodology that the Kentucky Department of Revenue was supposed to have made.[68] Furthermore, witness Waller stated that the alleged change in valuation methodology would increase the Company's anticipated ad valorem expense by $2 million per year.[69]

The Kentucky Legislature in its 2025 regular session enacted HB 775 [70] which, *inter alia*, modifies KRS 132.010 to clarify without date restrictions that gas pipelines constitute real property instead of personal tangible property, and therefore are subject to lower ad valorem taxes.[71] Therefore, witness Waller's upward adjustment of $500,000 is irrelevant and inapplicable, and in fact at the hearing he withdrew this $500,000 adjustment.[72]

Mr. Waller's escalation of ad valorem expense based on gross plant increases through the end of the test year should be rejected. The estimate he made and applied in his testimony applies to the ad valorem expense to be recorded in 2025 and was based in part on gross plant balances as of the January 1, 2025 valuation date. Mr. Waller's computed base year amount of $9.085 million is the expense that should be recorded throughout 2025, including nine months (April 2025 through December 2025) in the test year. The increase would be

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[66] Waller Rebuttal at 14:12.
[67] *Id.* at 13-14.
[68] Futral Direct at 14-15.
[69] Waller Rebuttal at 14. To account for the three months of the Test Period that fall in 2026, Mr. Waller adjusted his forecast ad valorem expense upward by $500,000. *Id.*
[70] Accessible at: https://apps.legislature.ky.gov/recorddocuments/bill/25RS/hb775/bill.pdf
[71] Ky. Legislature 2025 Regular Session, HB 775 §§ 4-5, introduced in the evidentiary hearing of this case as AG Exhibit 1.
[72] Video Transcript of Evidence (VTE), May 6, 2025 beginning at 13:20:30.

applicable only for the last three months of the test year (January 2026 through March 2026), based on the gross plant balances as of the January 1, 2026 valuation date. The gross plant as of January 1, 2026 was $937,666,750.[73] That amount multiplied by the ad valorem tax rate computed by Mr. Waller of 0.9985721% yields an annual expense amount of $9.363 million.[74] Nine months at $9.085 million in expense annually and three months of $9.363 million in expense annually yields a test year amount of $9.154 million, which is slightly less than the $9.169 million recommended by Mr. Futral and is based on more current information supplied by Mr. Waller in Rebuttal. Should the Commission decide to modify Mr. Futral's recommendation, the reduction in ad valorem expense would be $3.231 million. That would equate to a revenue requirement reduction of $3.27 million after the gross-up for bad debt and Commission assessment fees.

d. <u>Share 50% of Corporate Expenses for Directors & Officers Insurance and Investor Relations With Shareholders</u>

Atmos allocates certain shared services expenses to its operating divisions, including the Kentucky division, based on the composite allocation factor. These expenses include Director's and Officer's (D&O) insurance, and investor relations expense, for which the Kentucky division was allocated $0.200 million[75] and $0.037 million,[76] respectively.

Expense for both D&O insurance and investor relations provide a major benefit to the Company's shareholders. For example, the subject matter of many lawsuits filed against investor-owned utilities such as Atmos and its board members can involve issues such as stock

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[73] Atmos response to AG-PHDR1-01.

[74] Atmos Rebuttal Ex. GKW-R-1 at page 91 of 136, line 11 not rounded.

[75] The Board of Directors expense was broken down into directors' retirement expense ($0.134 million) and directors compensation expense ($0.66 million). Futral Direct at 18-19. The Company provided an adjustment in Sch. F.11 to remove the full $0.0134 million applicable to director's retirement expense, to be consistent with the precedent set in Case Nos. 2018-00281 (Final Order dated May 7, 2019 at 27) and 2017-00349 (Final Order dated May 3, 2018 at 18-19); *see also* Waller Direct at 33.

[76] Futral Direct at 19 (*citing* Response to AG 1-92, attached to Futral Direct as Ex. RAF-9).

performance, and a multitude of corporate governance issues such as shareholder derivative lawsuits. The Company's own website acknowledges that its investor relations unit provides press releases (advertising), investor presentations, dividend history, earnings per diluted share, regulatory filings with the U.S. Securities and Exchange Commission, and other statistical reporting information.[77]

The majority of benefits arising from these expenses are retained by Atmos' shareholders. As Mr. Futral points out, the Company *is already* sharing cost responsibility for Board compensation expense,[78] so there is no reason to prevent requiring a similar sharing for these expenses. Allowing Atmos to pass 100% of these expense items that primarily benefit shareholders and forcing them onto the backs of ratepayers is manifestly unfair, unjust and unreasonable. Mr. Futral recommends a 50/50 sharing of these expenses, which reduces D&O insurance expense by $0.065 million, and investor relations expense by $0.019 million, both of which would also have to be grossed up for bad debt and Commission assessment fees.[79]

e. Remove Dues for American Gas Association and Kentucky Chamber of Commerce

The American Gas Association (AGA) provides many different services to its dues-paying companies such as Atmos. Lobbying is not the AGA's sole service.[80] The same can be said for the Kentucky Chamber of Commerce. However, the AGA invoice sent to member companies such as Atmos identifies only the percentage of dues revenue devoted to lobbying.

[77] *See* Futral Direct at 19-20 (*citing* https://www.investors.atmosenergy.com/overview/default.aspx).
[78] Futral Direct at 19.
[79] Futral Direct at 20.
[80] "AGA is an advocate for natural gas utility companies and their customers and provides a broad range of programs and services for member natural gas pipelines, marketers, gatherers, international natural gas companies, and industry associates." Waller Rebuttal Ex. GKW-R-3, p. 3 of 32 (AGA Comments submitted in FERC Docket RM22-5-000, Rate Recovery, Reporting, and Accounting Treatment of Industry Association Dues and Certain Civic, Political, and Related Expenses (177 FERC ¶ 61,180)).

AGA also engages in legislative advocacy, regulatory advocacy, public relations, marketing, and advertising of both an institutional and promotional nature. The AGA does not track its expenses for these services. These activities provide no material benefit to ratepayers. As the Commission noted in Atmos' last rate case:

> ". . . Atmos Kentucky has the burden of establishing that costs it seeks to recover in rates for dues paid to associations like AGA do not include prohibited costs for lobbying and political activity, including costs for legislative lobbying, regulatory advocacy, and public relations."[81]

Atmos provided no evidence that dues passed on to its ratepayers are not used for legislative advocacy, regulatory advocacy, or public relations. The Commission in prior rulings made it clear that it will deny recovery of dues expense incurred for regulatory advocacy, public relations, and legislative advocacy.[82] In fact, the Commission in Atmos' last rate case excluded all dues expense from recovery.[83] Since Atmos did not establish that the dues it pays to these two organizations are not used for regulatory advocacy, public relations, and legislative advocacy, it cannot meet its burden of proof on this issue. Therefore, the Commission must exclude this expense. The effect is a reduction of $0.077 million in dues expense and a reduction of $0.078 million in the claimed base revenue requirement after the gross up for bad debt and Commission assessment fees.[84]

3. RETURN ON EQUITY AND CAPITAL STRUCTURE ISSUES

a. <u>Modify Capital Structure to Reflect Reasonable Levels of Common Equity, Long-Term Debt, and Short-Term Debt</u>

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[81] *In Re*: Electronic Application of Atmos Energy Corp. for an Adjustment of Rates, Case No. 2021-00214, Final Order dated May 19, 2022 at 23.

[82] *Id. See also*, *In Re*: Electronic Application of Louisville Gas & Elec. Co. for an Adjustment of its Electric and Gas Rates, etc., Case No. 2020-00350, Final Order dated June 30, 2021 at 27-30 (*citing* Case No. 2003-00433, An Adjustment of the Gas and Electric Rates, Terms and Conditions of Louisville Gas & Elec. Co., Final Order dated June 30, 2004 at 51).

[83] Case No. 2021-00214, Final Order dated May 19, 2022 at 23-25.

[84] Futral Direct at 22.

AG Witness Richard A. Baudino analyzed Atmos' proposed common equity ratio of 60.88%, finding it to be unreasonable, excessive, and recommending that the Commission reject it.[85] Instead, Mr. Baudino recommends that the Commission reset Atmos' common equity ratio to 52.5% in this case, which is consistent with the Commission's final order issued in Atmos' prior rate case,[86] and within the common equity ratios the Commission approved in recent rate cases filed by Columbia Gas of Kentucky and Delta Gas Company.[87, 88] Furthermore, a 52.5% common equity ratio makes additional progress toward the common equity ratio of the proxy group, which is approximately 49% - 50%.[89]

Mr. Baudino analyzed the common equity ratio for the companies in the two proxy groups that both he and Atmos witness D'Ascendis utilized in this case.[90] The 2024 average common equity ratio for Mr. Baudino's proxy group is 49.79%, and 49.17% for Mr. D'Ascendis' group.[91] Atmos' requested common equity ratio thus weighs in at a whopping 20.5% higher than the proxy group average. Further, Atmos witness Christian's recommended common equity ratio stands in *sharp* contrast to the Commission's final order in Atmos' last rate case, Case No. 2021-00214, in which the Commission ordered Atmos to reduce its common equity ratio, and placed the Company on notice that in a subsequent rate case the Commission may further reduce its common equity ratio to more closely

[85] Baudino Direct at 3.
[86] Case No. 2021-00214, Final Order dated May 19, 2022.
[87] *See In Re*: Electronic Application of Columbia Gas of Kentucky, Inc. for an Adjustment of Rates, etc., Case No. 2024-00092, Final Order dated Dec. 30, 2024 at 46. Additionally, a settlement is pending before the Commission in another case (*In Re*: Electronic Application of Delta Natural Gas Co., Inc. for an Adjustment of Gas Rates, Case No. 2024-00346), in which the parties jointly recommended that the Commission approve the Company's as-filed capital structure of 52.76% common equity, 47.24% long-term debt and 0% short-term debt (*See* Joint Stipulation filed on April 14, 2025).
[88] Baudino Direct at 3-4, 36.
[89] Baudino Direct at 4:6-8.
[90] *Id.* at 35.
[91] *Id.,* Table 2.

approximate that of its peers.[92, 93] Rather than adhere to the Commission's order — and heed its cautions — the Company in the instant case actually increased its common equity ratio to a level *greater* than what it sought in Case No. 2021-00214.

Company witness Christian provided a two-fold attempted justification for the ultra-high common equity component: first, that its proposed capital structure is an actual cost for the Company on a consolidated basis, and second, mere speculation that Atmos could somehow be downgraded by rating agencies.[94] Atmos' choice of a forecast test year in this proceeding means that its preferred capital structure is also hypothetical. The Commission is not bound by actual costs in a historic base period, nor by what the Company achieves in other states. Witness Christian failed to mention that transferring more of its financing costs into long-term debt would reduce costs to the Company and its ratepayers. Mr. Christian's purported concern of a ratings downgrade should the Company not receive its preferred ultra-high common equity ratio is mere speculation, and does not constitute evidence. The Commission's key task should be to examine the reasonableness of the capital structure. Record evidence establishes that Atmos' cost of capital is blatantly excessive and thus unreasonable.[95]

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[92] *Id*. at 3. *See also* Case No. 2021-00314, Final Order dated May 19, 2022 at 29-30, 38 (*citing* Direct Testimony of AG Witness Richard A. Baudino in that prior docket, at 29-31, in which Mr. Baudino recommended reducing the common equity ratio from 57.05% to 53.50%, halfway between the proposed amount and the average of the gas proxy group, as a first step towards movement to a common equity ratio that is more in line with the proxy groups).

[93] As far back as Atmos' 2018 base rate case in docket 2018-00281, the Commission expressed concern regarding the size of Atmos' common equity ratio, and agreed with the Attorney General that it was excessive compared to its peers, and results in an increase in the cost of capital and base revenue requirement. The Commission at that time accepted the filed equity component, but cautioned the Company about the high common equity ratio and placed it on notice that in a future rate filing, the Commission may make adjustments to Atmos' common equity ratio, for ratemaking purposes, to be comparable to its peers. Case No. 2018-00281, Final Order dated May 7, 2019 at 34-35.

[94] Christian rebuttal at 2-5.

[95] Baudino Direct at 33-36.

Just as the AG argued in Atmos' last rate case, the Company's proposed common equity ratio in the instant case is far beyond traditional norms, and exceeds the Company's needs for its Kentucky operations. Atmos has lower-cost financing options available to it, but refuses to utilize those means. Allowing Atmos to maintain the highest common equity ratio of any investor-owned utility in the Commonwealth harms ratepayers by forcing them to pay unreasonable profits to shareholders.[96] It is simply outrageous that rather than heeding the Commission's warning, Atmos instead chose to pursue a common equity ratio even *greater* than it requested in Case No. 2021-00214. Atmos' choice in this regard is nothing short of *galling*, and the Commission should reject it.

b. <u>AG Witness Baudino's ROE Recommendations</u>

Mr. Baudino recommends that the Commission authorize a return on equity (ROE) for Atmos of 9.4%.[97] His recommendation is based on: (i) the results of a discounted cash flow (DCF) analysis applied to a proxy group of seven natural gas distribution companies; and (ii) Capital Asset Pricing Model (CAPM) analyses using historical and forecasted risk premiums as well as publicly available estimates of market risk premiums from other sources.[98]

In estimating his recommended ROE for Atmos, Mr. Baudino utilized the DCF and CAPM models, applying them to a group of seven proxy gas distribution companies developed by Company witness D'Ascendis, which Mr. Baudino supplemented with one additional company.[99] Mr. Baudino DCF analyses utilized the standard constant growth form

[96] Case No. 2021-00214, Final Order dated May 19, 2022 at 34 (*citing* Attorney General's Final Brief in that prior docket at 25-27).
[97] Baudino Direct at 2. Mr. Baudino further recommended that with regard to Atmos' Pipeline Replacement program, the Commission should approve an ROE 10 basis points lower, at 9.30%. *Id.* at 37.
[98] *Id*. at 3.
[99] *Id*. at 14.

of the model that employs four different growth rate forecasts from the Value Line Investment Survey, S&P Capital IQ, and Zacks. Mr. Baudino's CAPM analyses utilized both historical and forward-looking data, as well as sources that provide additional recommendations for the market risk premium portion of the CAPM. These analyses support the reasonableness of his ROE recommendation.[100]

(i) <u>DCF Model</u>

Mr. Baudino determined initially that the proxy group selection criteria that Mr. D'Ascendis utilized were reasonable.[101] However, Mr. Baudino added Chesapeake Utilities due to the fact that the D'Ascendis proxy group consists of only six companies, which could raise concerns due to the group's relatively small size.[102] Mr. Baudino first determined that the 6-month dividend yield for his proxy group is 3.53%, and 3.76% for the D'Ascendis proxy group.[103] In order to determine the investors' expected growth rate for the proxy group, which correctly forecasts the constant dividend growth rate, Mr. Baudino used analysts' growth forecasts provided by Value Line, S&P Capital IQ, and Zacks.[104] Mr. Baudino explained that these analysts' growth forecasts, which are widely available to investors, provide better proxies for the expected growth component in the DCF model than historical growth rates.[105]

Baudino Exhibit RAB-3 depicts the forecasted dividend and earnings growth rates from Value Line, the earnings growth forecasts from S&P Capital IQ and Zacks for the proxy group companies, and presents Mr. Baudino's standard method of calculating dividend yields,

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[100] *Id.*
[101] *Id.* at 16.
[102] *Id.*
[103] *Id.* at 17 (*citing* Ex. RAB-2 attached to Baudino Direct).
[104] *Id.* at 18.
[105] *Id.* at 19.

growth rates, and ROE for the proxy group.[106] Mr. Baudino utilizes two different methods to calculate his DCF ROE: Method 1 uses the proxy group's average growth rates, and Method 2 utilizes median growth rates.[107] Method 1 results range from 8.25% to 9.75%, with the average of these results being 9.33%. Method 2 results range from 8.11% to 10.14%, with the average of these results being 9.46%. Mr. Baudino then applied this approach to Mr. D'Ascendis' proxy group, with the results depicted on page 2 of Exhibit RAB-3. The average results were somewhat lower, ranging from 9.23% to 9.36%.[108]

(ii) <u>Capital Asset Pricing Model</u>

Mr. Baudino explained that the CAPM model identifies two types of risks for a security: company-specific risk (events such as strikes, management errors, marketing failures, lawsuits, and other events unique to a particular firm), and market risk (including inflation, business cycles, war, variations in interest rates, and changes in consumer confidence).

Market risk tends to affect all stocks and cannot be diversified away. The idea behind the CAPM is that diversified investors are rewarded with returns based on market risk.[109] In the CAPM model, the expected return on a security is equal to the risk-free rate of return plus a risk premium that is proportional to the security's market, or non-diversifiable risk. Beta is the factor that reflects the inherent market risk of a security and measures the volatility of a particular security relative to the overall market for securities. For example, Stocks with a beta of 0.5 will only rise or fall 50% as much as the overall market, while stocks with betas greater than 1.0 will rise and fall more than the overall market.[110] Investors are risk averse and will

[106] *Id.* at 19-20.
[107] *Id.* at 20.
[108] *Id.* at 21.
[109] *Id.* at 21.
[110] *Id.* at 22.

only accept higher risk if they expect to receive higher returns.[111] The general level of risk aversion in the economy determines the market risk premium (MRP).[112] Any stock's risk premium can be determined by multiplying its beta by the MRP, then the total return can be estimated by adding the risk-free rate to that risk premium.[113] Stocks with betas greater than 1.0 are considered riskier than the overall market and will have higher required returns. Conversely, stocks with betas less than 1.0 will have required returns lower than the market as a whole.[114]

Mr. Baudino also points out that there has been controversy over use of the CAPM model, and its accuracy regarding expected returns.[115] Mr. Baudino further notes there is substantial evidence that beta is not the primary factor for determining a security's risk.[116] Moreover, substantial judgment is required in estimating the required market return and MRP, and an analyst's judgment can significantly influence CAPM results.[117] The CAPM theoretically requires an estimate of return on investments, but in reality it is nearly impossible for analysts to estimate such broad-based returns.[118] Additionally, use of historical MRP calculated over a long period of time increases the risk of upward bias.[119] In order to mitigate this bias, Mr. Baudino supplemented his analysis with additional sources set forth in his testimony.[120]

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[111] *Id*.
[112] *Id*.
[113] *Id.* at 22-23.
[114] *Id*. at 23.
[115] *Id*. at 23.
[116] *Id.* at 23-24 (*quoting* Shannon Pratt & Roger Grabowski, *Cost of Capital* at 269 (5th ed 2014)(". . . despite its wide adoption, academics and practitioners alike have questioned the usefulness of CAPM in accurately estimating the cost of equity capital and the use of beta as a reliable measure of risk.").
[117] *Id.* at 24.
[118] *Id*.
[119] *Id*. at 27-28 (*citing* Pratt and Grabowski, *Cost of Capital*, at 119 (Wiley, 5th ed.); and Dr. Aswath Damodaran, *Equity Risk Premiums (ERP): Determinants, Estimation, and Implications – The 2022 Edition, Updated: March 23, 2022.*
[120] *Id.* at 28-30. *See also* Ex. RAB-4 attached to his testimony, p. 3.

(iii) Summary of Rate of Return Recommendations Compared to Company

AG Witness Futral's testimony includes the following table setting forth the AG's recommendations regarding the Company's capital structure and cost of capital:[121]

Table 4
Atmos Energy Corporation
Cost of Capital
KPSC Case No. 2024-00276

Atmos Cost of Capital Per Filing

	Capital Ratio	Component Costs	Weighted Avg Cost	Grossed-Up WACC
Short Term Debt	0.19%	17.14%	0.03%	0.03%
Long Term Debt	38.93%	4.11%	1.60%	1.62%
Common Equity	60.88%	10.95%	6.67%	8.99%
Total Capital	100.00%		8.30%	10.64%

Atmos Cost of Capital Recommended by AG

	Capital Ratio	Component Costs	Weighted Avg Cost	Grossed-Up WACC
Short Term Debt	0.19%	17.14%	0.03%	0.03%
Long Term Debt	47.31%	4.11%	1.94%	1.96%
Common Equity	52.50%	9.40%	4.94%	6.66%
Total Capital	100.00%		6.91%	8.65%

The AG urges the Commission to adopt this capital structure.

(iv) Quantification of AG Witness Baudino's Recommendations

AG Witness Baudino's recommendation that the Commission adopt an ROE of 9.40% for Atmos[122] reduces the Company's base revenue requirement and base rate increase by $6.549 million.[123] Additionally, his modification to reduce Atmos' common equity ratio reduces the Company's base revenue requirement and base rate increase by $5.375 million.[124]

[121] Futral Direct at 23-24, Table 4.
[122] Baudino Direct at 33. Mr. Baudino's recommendations are discussed in greater detail, *infra*.
[123] Futral Direct at 23.
[124] Futral Direct as 22-23.

c. **<u>Atmos' ROE Demand is Unreasonable</u>**

AG witness Baudino opines that Company witness D'Ascendis' recommendation of a 10.95% ROE is grossly excessive and would inflate the Company's revenue requirement and harm its Kentucky ratepayers.[125] Accordingly, Mr. Baudino recommended the Commission reject Mr. D'Ascendis recommendation.

(i) <u>DCF Analysis</u>

Mr. Baudino criticized Mr. D'Ascendis' failure to consider Value Line's dividend growth forecast in his analysis, as dividends are a significant portion of the total utility shareholder return.[126] Mr. D'Ascendis' failure to include this vital data overstated his DCF analysis. [127] Mr. Baudino's DCF results are lower than Mr. D'Ascendis DCF results primarily due to Mr. Baudino's use of updated stock prices and growth rates, as well as Value Line's projected dividend growth rates.[128] Mr. D'Ascendis' failure to include dividend growth forecasts overstated his DCF results.[129]

(ii) <u>Risk Premium Model Analyses</u>

Mr. Baudino cautions against over-relying on the Risk Premium Model (RPM), because it is a "blunt tool" that yields imprecise results.[130] Furthermore, he opines that the RPM approach, ". . . can only provide very general guidance on the current authorized ROE . . . ." [131] The better approach is a properly formulated DCF model using current stock prices and growth forecasts, which is far more reliable and accurate than the bond yield plus risk

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[125] Baudino Direct at 38.
[126] Baudino Direct at 40.
[127] *Id.*
[128] *Id.*
[129] *Id.*
[130] Baudino Direct at 40-41.
[131] *Id*. at 40.

premium models that rely on an historical analysis of risk premiums.[132] This is significant because much of Mr. D'Ascendis' RPM analyses are based on historical risk premium analyses that may have no relevance in today's marketplace.[133] Moreover, Mr. D'Ascendis' use of more forward-looking analyses resulted in systematically overstating his risk premiums.[134] Both of these general problems led directly to excessive MRP ROEs for Atmos.[135]

Mr. D'Ascendis used historical market returns as one method of estimating the MRP, but he did not address the potential for the overstatement of historical risk premiums.[136] Additionally, Mr. D'Ascendis utilized a statistically insignificant regression analysis to forecast risk premiums.[137] Statistical tests are used to assess the validity of such regression analyses, one such test being the R-squared statistic.[138] R-squared results fall between 0 and 1, with higher values indicating a higher degree of statistical significance.[139] For example, an R-squared result of 0.8 means the analysis explains 80% of the variation in the monthly risk premium.[140] However, Mr. D'Ascendis' regression analysis has an R-squared value of only 0.0276, meaning that his model only explains about 2.76% of the total variation in historical market risk premiums.[141] As Mr. Baudino noted, "[t]his is a poor result and means that his model cannot and should not be relied upon to predict market risk premiums based on

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[132] *Id.* at 41.
[133] *Id.*
[134] *Id.*
[135] *Id.* at 41, 49-51.
[136] *Id.* at 42. Mr. Baudino noted: "There is credible analysis that historical risk premiums may be overstated due to (1) rising price/earnings ratios that are not expected to persist and (2) the "World War II bias", both of which I explained in Section III of my Direct Testimony. Mr. D'Ascendis did not address these two potential sources of overstatement of the MRPs in his historical analysis." *Id.*
[137] *Id.* at 42-43.
[138] *Id.* at 43.
[139] *Id.*
[140] *Id.*
[141] *Id.*

changes in bond yields."[142] Another measure of statistical accuracy, the t-statistic, shows statistical significance for bond yields Mr. D'Ascendis used in his regression model, but Mr. Baudino cautions that, ". . . the explanatory power of the model is so poor that it cannot be used accurately for forecasting purposes."[143] The two regression analyses Mr. D'Ascendis used to estimate risk premiums for his Risk Premium ROE, and the one he used for his CAPM ROE have little — if any — predictive value. Therefore, the Commission should reject Mr. D'Ascendis' regression analyses.[144]

In the instant case, Mr. D'Ascendis continues to rely upon the Predictive Risk Premium Model (PRPM), which the Commission rejected in Atmos' last rate case, finding:

> "Even though the Commission supports the use and presentation of multiple modeling approaches, the Commission finds that Atmos Kentucky's use of the Predictive Risk Premium Model (PRPM) should be rejected. Though the PRPM model has been published and presented in multiple forums, it has been rejected by this Commission and only been addressed by three other regulatory commissions thus far and is not universally accepted."[145]

The PRPM utilizes proprietary software to analyze historical variances in risk premiums.[146] This methodology is premised upon the assumption that historical data regarding investor required returns and expectations will persist into the future.[147] However,

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[142] *Id.*
[143] *Id.* at 43-44.
[144] *Id.* at 44-45. Mr. Baudino further explains that Mr. D'Ascendis used two additional regression analyses to estimate risk premiums: (a) analysis of monthly historical equity risk premiums between the S&P Utility Index and Moody's A2-rated public utility bond yields, which resulted in a risk premium of 4.86%; and (b) analysis of the monthly annualized historical returns on the S&P 500 relative to historical yields on long-term U.S. Government Securities, which resulted in a market equity risk premium of 7.99% that was used in Mr. D'Ascendis' CAPM analysis. However, both of these analyses suffered from the same flaws and had R-squared values of 0.013, and 0.019, respectively, meaning they had little if any predictive value. *Id.*
[145] Case No. 2021-00214, Final Order dated May 19, 2022 at 47-48. The Florida Public Service Commission also rejected the PRPM, finding: "The record failed to support that witness D'Ascendis' PRPM methodology is widely accepted by other jurisdictions as a method to estimate the equity risk premium" (Florida PSC Docket 20200139-WS). Baudino Direct at 46.
[146] Baudino Direct at 45-47.
[147] *Id.* at 47.

Mr. D'Ascendis did not introduce any evidence into the record to support this assumption.[148] As Mr. Baudino points out, "Whether or not this information accurately portrays investor required returns and expectations is highly questionable."[149] The notion that investors expect the variance of historical risk premiums to continue or if they even use this information at all to assist them in determining their required ROE is, frankly, speculative at best. Moreover, incorporating the 8.11% PRPM results in an ROE of 12.0%, which Mr. Baudino opines is clearly excessive, when compared with commission-allowed ROE data supplied in Mr. D'Ascendis' work papers.[150]

Additionally, Mr. D'Ascendis' other risk premium estimates produced similarly unreasonable results, one producing an ROE of 13.75%, and the other 11.24%.[151] As Mr. Baudino noted, "These ROE results are so far removed from current commission-allowed ROE and from the reality of current capital markets that they should be summarily rejected."[152]

Mr. D'Ascendis' projected MRP is predicated upon earnings growth rates of 10.11% and 13.99%.[153] These growth rates are unrealistic, and inevitably lead to an overstatement in the long-run expected market return, the associated MRP, and the ROE result.[154] Mr. Baudino further characterized them as:

> ". . . unsustainably high in that they vastly exceed both the historical capital appreciation for the S&P 500 as well as historical and projected GDP growth rates. Kroll's historical analysis shows that the arithmetic average capital appreciation for the S&P 500 was 7.9% for the historical period 1926 to 2022 [footnote omitted]. Geometric, or compound growth

[148] *Id.* at 45.
[149] *Id.* at 47.
[150] *Id.*
[151] *Id.* at 48.
[152] *Id.*
[153] *Id.* at 49.
[154] *Id.* at 50.

> was 6.1%. This historical experience stands in stark contrast to Mr. D'Ascendis' forecasted growth rate of 13.99%."[155]

Historical and forecasted GDP growth, based upon data from the U.S. Department of Commerce, Bureau of Economic Analysis, establishes that the compound yearly growth rate for U.S. GDP from 1929 to 2023 was 6.1%.[156] Significantly, this growth rate matches the historical compound growth rate for capital appreciation for the S&P 500 of 6.1% from Kroll.[157] The fact that these two growth rates match lends even more credence to their validity.

Finally, Mr. D'Ascendis relied upon another risk premium approach based on his regression analysis of state utility commission authorized ROEs.[158] Mr. D'Ascendis states that this analysis assumes that investor-required ROEs are deterministically based on an average of these historical commission-allowed ROEs and the risk premium relationship posited by his regression analyses.[159] However, Mr. D'Ascendis failed to produce evidence that investors in gas utility stocks adopt this mechanistic approach to formulate their expected ROEs.[160]

(iii) <u>CAPM and Empirical CAPM</u>

The results of Mr. D'Ascendis' CAPM and Empirical CAPM (ECAPM) analyses range from 11.27% to 11.37%.[161] Mr. Baudino criticizes these results as being "grossly overstated" for gas utilities such as Atmos, which the Commission should reject out of hand.[162] The last time utility ROEs were anywhere in that range was 2002, when the average

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155 *Id*. at 49. Mr. Baudino also quotes the authoritative treatise *Cost of Capital* (quoting Shannon Pratt and Roger Grabowski (Wiley, 5th ed.) at 1195): "Long-term growth rates exceeding the real growth in GDP plus inflation are generally not sustainable."
156 Baudino Direct at 49-50.
157 *Id.* at 50. Mr. Baudino also cites other growth forecasts that are even lower: 3.8% nominal GDP growth from the Federal Reserve, and a similar forecast from the Congressional Budget Office. *Id.*
158 *Id.* at 51.
159 *Id.*
160 *Id.*
161 *Id*. at 52 (*citing* D'Ascendis' Exhibit DWD-4, page 1).
162 *Id*. at 52.

A-rated utility bond yield was 6.66%. However, the December 2024 Mergent average utility bond yield was 5.60%, a full 106 basis points lower than 2002.[163] Therefore, the 11.27% - 11.37% range of Mr. D'Ascendis CAPM results lack credibility, and inflate his ROE recommendations.[164]

Mr. D'Ascendis utilized five separate risk premium analyses in estimating the expected MRP for the CAPM/ECAPM.[165] However, Mr. D'Ascendis failed to evaluate the potential for overstatement based on the "supply-side" MRP and the "supply-side MRP less WWII bias."[166] As a result, Mr. D'Ascendis' MRP is overstated, and contributes to an excessive CAPM result.[167] The result of Mr. D'Ascendis' CAPM analysis based on the projected Value Line *Summary and Index* and Value Line/Bloomberg/S&P MRPs is 11.84%. The source of the ROE overstatement is the excessive earnings growth rates that Mr. Baudino discussed previously in regard to Mr. D'Ascendis' MRP results, [168] and the failure to use the additional MRP resources Mr. Baudino discussed in his testimony.[169] When compared with historical allowed returns as a rough benchmark, this result is clearly unreasonable.[170]

Finally, Mr. Baudino notes that the ECAPM method was created in large part to address the possibility that CAPM understates ROE for companies with batas less than 1.0.[171] Mr. Baudino opines that this is simply more evidence of the inherent lack of accuracy in the

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163 *Id.*
164 *Id.*
165 *Id*. at 52-53, and Table 3, which depicts the MRPs for each method Mr. D'Ascendis used.
166 *See* Baudino Direct at 26-28.
167 Baudino Direct at 53.
168 *Id.* at 54.
169 *See* Baudino Direct at 29-30, and Baudino Ex. RAB-4. Mr. Baudino also notes, at 55, that Mr. D'Ascendis' 8.63% MRP exceeds the top range of risk premium identified in the authoritative work, *Principles of Corporate Finance* (Brealey, Myers, Allen and Edmans, McGraw-Hill/Irwin, 14th Edition, 2023, at 189).
170 *Id*. at 54.
171 *Id*. at 55.

CAPM, and in published betas.[172] Additionally, Mr. D'Ascendis presented no evidence that investors favor the ECAPM over the standard CAPM.[173]

(iv) Non-Utility Group ROE

Mr. Baudino criticizes Mr. D'Ascendis' inclusion of non-utility, non-price regulated Companies as an additional method of evaluating the fair rate of return.[174] Utility companies with protected territories may increase prices when demand or customer count falls, but competitive entities face risks that regulated companies such as Atmos do not face.[175] The competitive companies in Mr. D'Ascendis' Exhibit DWD-6 have average ROEs ranging from 11.29% to 12.53%, which are far higher than the utility proxy groups that both Messrs. Baudino and D'Ascendis utilized, and far higher than Mr. Baudino's CAPM results.[176] The Commission should reject Mr. D'Ascendis' request that the Commission consider these unregulated companies as a separate means of evaluating rate of return for Atmos.

(v) Adjustments to Cost of Equity

Mr. D'Ascendis proposed the following additional adjustments to his ROE: a size adjustment of 5 basis points; a credit risk adjustment to reduce ROE by 4 basis points; and a flotation cost adjustment of 6 basis points.[177] Mr. D'Ascendis acknowledged that the Commission has consistently rejected these adjustments, but he offered no new or additional information to support the Company's requests. The Commission should continue to reject them, consistent with prior cases.

(vi) Size Adjustment

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172 *Id*.
173 *Id*.
174 *Id*. at 56.
175 *Id*.
176 *Id*.
177 *Id*. at 57.

Mr. D'Ascendis asserts that Atmos-Kentucky's small size warrants an upward adjustment in its ROE. Mr. Baudino opined that Atmos should not be evaluated as a stand-alone company.[178] Atmos-Kentucky is one of seven operating divisions, and the Kentucky Division does not issue its own debt and equity.[179] Moreover, Mr. D'Ascendis' assumption that investors would somehow carve out and require a small company ROE premium for an unincorporated operating division is baseless.[180]

(vii) Flotation Costs

Flotation cost adjustments attempt to recognize and collect the costs of issuing common stock.[181] Such costs typically include legal, accounting, and printing costs as well as broker fees and discounts. Mr. Baudino testified that these costs are likely already accounted for in stock prices.[182] Thus, an adjustment essentially assumes that the current stock price is wrong. Mr. Baudino noted: "This is not an appropriate assumption regarding investor expectations or current stock prices. Stock prices most likely already account for flotation costs, to the extent that such costs are even considered by investors."[183]

4. COMPOSITE FACTORS FOR DIVISIONS 002, 012 and 091

Atmos allocates costs incurred at the corporate level to the Kentucky/Mid-States Division using composite factors.[184] The composite factors for each division are comprised of three components with equal weighting: gross direct property plant and equipment, average number of customers, and total O&M expense.[185] AEC uses various versions of the composite

[178] *Id*. at 58.
[179] *Id*.
[180] *Id*. at 59.
[181] *Id*. at 60.
[182] *Id*.
[183] *Id*.
[184] Futral Direct at 24.
[185] *Id*. at 25.

factor, *e.g.*, all companies, utility, and regulated only, among others.[186] However, the composite factors identified in Atmos' application are not the most current ones available.[187] Shortly after the Company filed its application in this case, it began closing the books on its fiscal year ending September 20, 2024, and updated its composite factors as part of that process.[188] The new factors were provided through discovery responses.[189] As a result of these new composite factors, the percentage allocations to the Kentucky rate division decreased.[190] Mr. Futral recommends that the Commission modify the composite allocation factors to reflect the updated versions available.[191] The effect is a reduction of $0.526 million in the Company's base revenue requirement and base rate increase.[192] The Company agreed to this adjustment in its rebuttal testimony.[193]

5. SUMMARY OF AG ADJUSTMENTS TO ATMOS' REQUESTED BASE RATE INCREASE

As set forth in the Futral Direct testimony, the AG recommends that the Commission authorize an increase in Atmos' base revenues of no more than $11.751 million, a reduction of $21.250 million from the Company's requested increase of $33.001 million.[194]

6. PIPELINE REPLACEMENT PROGRAM AND RIDER AND CAPITAL EXPENDITURE CAPS

a. Deny Request to Include Accelerated Replacement of Aldyl-A Pipeline in the Pipeline Replacement Program and to Recover the Costs Through the PRP Rider

186 *Id.*
187 *Id.*
188 *Id.* at 25-26.
189 *Id.* at 26. *See* Response to AG-DR-1-71, attached to Futral Direct as Ex. RAF-11.
190 *Id.*
191 *Id.*
192 *Id.*
193 Waller Rebuttal at 23:2-10.
194 Futral Direct at 4-5, and Table 1.

Atmos in this case seeks modification of the Pipeline Replacement Program (PRP) to allow accelerated replacement of Aldyl-A pipes based generally on "principles of Distribution Integrity Management," and to recover additional costs through Rider PRP.[195] The Company has identified specific sections of Aldyl-A that it believes need replacing, and believes that all of its Alydyl-A pipe can be replaced over a 7 to 10 year period.[196]

Atmos' original plan for replacement of bare and coated steel pipes has experienced significant delays and cost overruns. The Company continues to push back its time estimate for replacing all bare steel pipelines and to increase its cost estimates. The time estimate has now been delayed until some "additional years" beyond 2027.[197] Atmos has indicated it cannot provide a time estimate for completion of the bare steel replacement program.[198] As Mr. Kollen notes, "The Commission has expressed its frustration with the Company's performance in numerous base and PRP rate proceeding Orders."[199]

In order to address the Company's poor execution on replacing bare steel pipes, the Commission imposed caps on the recovery of costs associated with replacing bare steel pipes to mitigate the effects of the cost overruns and delays on PRP Rider rates charged to customers.[200]

- In Case No. 2017-00349, the Commission capped the Company's PRP capital spending at $28 million annually, and extended the original 15-year deadline to complete the replacement of bare steel by two additional years.[201]

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[195] Austin Direct at 50.
[196] *Id.*
[197] *Id*. at 32-33.
[198] Response to AG-DR-1-25, attached to Kollen Direct as Ex. LK-9.
[199] Kollen Direct at 29-30 (*citing* Case No. 2017-00349, *In Re:* Electronic Application Of Atmos Energy Corporation For An Adjustment Of Rates And Tariff Modifications).
[200] *Id.*
[201] Case No. 2017-00349, Final Order dated May 3, 2019, at 41.

- In Case No. 2018-00281,[202] the Commission: (a) refused Atmos' request to increase the capital spending caps; (b) found that safety concerns did not warrant the accelerated replacement of all Aldyl-A pipe; (c) held that prioritizing individual non-PRP projects within that limit on capital spending is a task to be performed by Atmos; (d) found that that projected capital spending on non-PRP projects should be limited to a rolling 5-year average; and (e) held that the Co. would have to provide evidence tying each proposed project to the Co.'s Distribution Integrity Management Plan (DIMP).[203]

- In Case No. 2021-00214,[204] the Commission approved inclusion of three specific Aldyl-A projects in the PRP, but rejected Atmos' request to recover costs in the PRP for replacing all Aldyl-A projects.[205]

- In Case No. 2022-00222,[206] the Commission approved inclusion of three additional Aldyl-A projects in the PRP.[207]

- In Case No. 2023-00231,[208] the Commission: (a) rejected recovery in the PRP of costs associated with four Aldyl-A projects; (b) kept the annual cap on PRP capex in place, but increased it from $28 million to $30 million; and (c) reiterated that for projects replacing segments other than bare steel, the Company should continue to demonstrate that the project is consistent with the evaluation and ranking of threats to its distribution system in its DIMP.[209, 210]

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202 *In Re*: Electronic Application Of Atmos Energy Corporation For An Adjustment Of Rates, Final Order dated May 7, 2019.
203 *Id*. at 24-25.
204 *In Re*: Electronic Application Of Atmos Energy Corporation For An Adjustment Of Rates, Final Order dated May 19, 2022.
205 *Id.* at 60.
206 *In Re*: Electronic Application Of Atmos Energy Corporation To Establish PRP Rider Rates For The Twelve Month Period Beginning October 1, 2022, Final Order dated May 25, 2023.
207 *Id*. at 3.
208 *In Re*: Electronic Application Of Atmos Energy Corporation For PRP Rider Rates Beginning October 1, 2023, Final Order dated Sept. 29, 2023.
209 *Id*. at 11-19.
210 The Commission also reiterated the necessity of prioritizing projects through the Company's DIMP: "Reliance on Atmos's DIMP in choosing pipeline safety projects is important to ensure that Atmos is making investments in the projects that create the highest risk. Prioritizing projects based on the DIMP also provides a quick method for assessing whether a project is needed, which is necessary when reviewing PRP projects given the expedited review anticipated by the PRP rider. While it indicated that the proposed Aldyl-A projects are high priority, Atmos did not indicate that the projects proposed herein ranked the highest on its DIMP or explain why they should be prioritized over specific projects that rank higher, including why the projects should be prioritized over higher ranking bare steel projects in this and subsequent years. Thus, absent significant discovery not anticipated by the PRP rider, the Commission is not able to find that safety concerns justify including the Aldyl-A projects proposed in fiscal year 2024 in the PRP rider, and therefore, finds that the costs associated with the Aldyl-A projects proposed to be added in this PRP program year should be removed from the PRP revenue requirement calculation."

The Commission should view Atmos' prior history of poor execution on the bare steel replacement program as the best predictor of how the Company will perform if the Commission authorizes a new massive replacement program on top of the one which it seems unable to complete.[211] The Company failed to meet its original cost estimates and timeline, and now cannot or will not provide a current and realistic cost estimate and time schedule for completion of the bare steel pipe program. Similarly, it failed to provide any cost estimates and time schedule to completely replace Aldyl-A pipes, until after the hearing in this matter.[212] The cost overruns and repeated schedule delays encountered in the bare steel replacement program are likely to be repeated in any Aldyl-A replacement program. Given the cost uncertainties that exist in the pending bare steel program, the addition of a new replacement program on top of the existing one poses enormous rate risk for Atmos ratepayers.

Under the Commission's present regulatory approach, Atmos is allowed to replace any project-specific section of any type of pipe if it is prioritized in accordance with the Company's DIMP. The Commission should maintain this approach. Just as the Commission denied Atmos' prior requests for a broad-based Aldyl-A replacement program,[213] it should reject the Company's current proposal to turn the clock back to the open-ended, unrestrained type of program[214] it had before the final order was issued in the 2017 rate case.[215] As Mr. Kollen notes:

> "The Commission has already made its determination and repeatedly affirmed it. The Commission's repeated decisions and the decision specifically in Case 2023-00231 should be affirmed. "[T]he inclusion of

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[211] Kollen Direct at 30.
[212] Response to AG 1-26, attached to Kollen Direct as Ex. LK-10; s*ee also* Response to Staff-PHDR-3, Attachment 1 in which the Company now estimates the total cost of replacing all Aldyl-A pipes at $243.7 million.
[213] Case Nos. 2021-00214, and 2023-00231.
[214] Kollen Direct at 32-33.
[215] Case No. 2017-00349, Final Order dated May 3, 2019.

> future Aldyl-A projects in the PRP [will] be determined on a case-by-case basis."[216]

b. <u>Deny Request to Remove Annual Caps on PRP and Non-PRP Capital Expenditures</u>

Only two years ago, the Commission reconfirmed that Atmos must continue to limit its capital spending for both PRP and non-PRP spending, although it authorized an increase in the cap from $28 million to $30 million annually.[217] As Mr. Kollen recommends, the caps should remain in place because the Company has failed to demonstrate that it can properly control and manage its costs and schedules.[218] Nonetheless, Atmos still has the ability to seek recovery of either PRP or non-PRP capex that exceeds the cap, as long as the Company provides supporting documentation establishing how each project is consistent with its DIMP or TIMP.[219] The Commission has frequently explained that the caps are *not* hard caps, as evidenced by the Commission's willingness to consider costs in excess of the caps based on its review of the facts and circumstances. As Mr. Kollen points out, "the caps remain necessary to impose some restraint and discipline on the Company's capital expenditures and the costs included in the PRP and base revenue requirements."[220]

Nonetheless, if the Commission is inclined to grant Atmos' request to remove the caps, it could as an alternative consider an annual escalation factor to increase the caps, based on changes to the Consumer Price Index.[221]

7. PROPOSED TAX RIDER

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[216] Kollen Direct at 33 (*quoting* Case No. 2023-00231, Final Order dated Sept. 29, 2023 at 13).
[217] *Id.*
[218] *Id*. at 34.
[219] Id. at 34-35 (*citing* Case No. 2018-00281, Final Order dated May 7, 2019 at 25).
[220] *Id*. at 35.
[221] *See* hearing cross-examination of AG witness Lane Kollen, VTE, May 7, 2025 beginning at 9:51:45.

In its application, Atmos seeks authority to implement a new rider designed to capture the effects of changes to tax laws, including but not limited to the Tax Act 2022 which included such items as the Corporate Alternative Minimum Tax (CAMT) deferred tax asset (DTA).[222] The Tax Rider would also capture any changes to state income and property taxes. Atmos' proposed Tax Rider would calculate amounts due under the CAMT DTA each year, followed by an annual true-up.[223]

There is no need for this Tax Rider. The Commission already has a tried-and-true process for dealing with tax changes. The most recent major change to federal tax law occurred in the Tax Cuts and Jobs Act (TCJA),[224] which led the Commission to initiate generic and company-specific proceedings for the gas and electric utilities subject to its ratemaking jurisdiction.[225] Through this process, the Commission was able to address the issues on a consistent statewide basis while allowing for differences among the utilities based on their unique facts and circumstances.[226] The Commission's existing process is also sufficient to address other federal and state tax code changes that do not affect tax rates, but do alter tax rates, credits and deductions.[227]

Moreover, the proposed Tax Rider would pose new problems with how the Commission handles tax issues. The Tax Rider would force the Commission to delegate its legal authority to the Company, requiring the Commission to preemptively approve how the Company chooses to treat deficient DTAs and excess deferred tax liabilities (DTLs). Such a

[222] Kollen Direct at 35-36.
[223] *Id.*
[224] Public Law 115–97—Dec. 22, 2017 (131 Stat. 2054; H.R. 1, 115th Congress 2017-2018).
[225] Kollen Direct at 37.
[226] *Id.*
[227] *Id.*

delegation of the Commission's legal authority is contrary to law, and likely unconstitutional. As Mr. Kollen notes:

> "Historically, there have been significant disagreements among the utility and other parties as to the deficient DTAs that should be recovered from and the excess DTLs that should be refunded to customers and the amounts of these recoveries or refunds, whether certain DTAs and DTLs are protected or unprotected, the amortization and recovery or refund period for the deficient DTAs or excess DTLs, and the allocation of the recoveries or refunds to customer classes and the recovery or refund from customers within each class."[228]

Regulated utility companies should not be making these types of decisions on their own. Furthermore, the proposed rider would attempt to treat all property taxes alike in sweeping, broad strokes, whereas in reality, numerous Kentucky jurisdictions assess property taxes through a plethora of methodologies, all of which are subject to negotiation and potential litigation. This is a complex process that cannot be reduced to a single formula.[229] The Tax Rider ignores these complexities.

Moreover, the Company should carry the constantly changing increases and decreases in property tax expense. This incentivizes the Company to negotiate with the taxing jurisdictions to ensure that property taxes are minimized. Additionally, these same taxing jurisdictions would be incentivized to extract the highest amount of taxes if they know the Company will not be negotiating, as would be the case if the Tax Rider is put into effect.[230]

Furthermore, the CAMT and CAMT DTA should not and do not apply to Atmos' Kentucky division on a standalone basis, as it is not a taxpayer or a separate legal entity.[231]

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[228] *Id*. at 37-38.
[229] *Id*. at 38.
[230] *Id*.
[231] *Id.* at 39.

Only AEC consolidated and AEHI as separate legal entities are applicable corporations subject to the CAMT. As Mr. Kollen concludes:

> "The Company's proposal is solely a ratemaking construct that will allow the Company to impose a cost on Kentucky customers that is incurred by AEC consolidated due to its unregulated activities. It has nothing to do with the regulated AEC utility divisions, let alone the Kentucky division on a standalone basis. Nor is the Commission required to include a CAMT DTA in rate base to comply with the IRS normalization rules."[232]

Finally, in Atmos' last rate case the Commission denied the Company's request for the "Tax Act Adjustment Factor" (TAFF), finding:

> "As the Attorney General argued, there are already multiple processes in place at the Commission's and Atmos Kentucky's disposal to address changes in the federal and state tax codes. Therefore, the Commission finds that the proposed Tax Act Adjustment Factor Rider is unreasonable and should not be approved."[233]

8. PROPOSED PIPELINE MODERNIZATION RIDER

Atmos seeks authorization for a new Pipeline Modernization (Rider PM), which would allow accelerated recovery of capital-related costs for transmission infrastructure not included in base rates or PRP rates, [234] including costs incurred for compliance with the Pipeline and Hazardous Materials Safety Administration's (PHMSA) Mega Rule.[235] Costs recoverable through Rider PM would include a grossed-up return on gross plant less accumulated depreciation, less accumulated deferred income taxes and the related depreciation and ad valorem tax expenses, offset by savings in O&M expenses, if any.[236] Although the proposed tariff's current wording is limited to recovery of Mega Rule

[232] *Id*. at 41.
[233] Case No. 2021-00214, Final Order Dated May 19, 2022 at 64.
[234] Application at 7.
[235] 84 Fed. Reg. 52180-52257 (Oct. 1, 2019)("Mega Rule Part 1"); 87 Fed. Reg. 52224-52279 (Aug. 24, 2022)("Mega Rule Part 2"); and 86 Fed. Reg. 63266-63299 (Nov. 15, 2021) ("Mega Rule Part 3").
[236] Kollen Direct at 42.

compliance costs, it leaves open the possibility that it could seek permission for recovery of other compliance costs.[237] Additionally, the scope and timing of compliance projects would be left to the Company's own judgment. The Company's inability or unwillingness to provide estimates of cost or the time needed to complete any identified projects is even more concerning, and indicative of the Company's incentive and likely intent to transfer the recovery of more costs through Rider PM as opposed to the present recovery through base rates.[238]

Rider PM will incentivize the Company to incur additional capital costs that it would not do without the rider, absent the caps the Commission has imposed on recovery of costs through the PRP Rider and on non-PRP costs through base revenues.[239] Moreover, if approved, the Company could attempt recovery of costs that were denied under Rider PRP. Such could become the case if the Company were to attempt recovery of costs to systematically replace all Aldyl-A pipes.[240]

The Company does not require Rider PM in order to recover Mega Rule compliance costs — in fact, the Company confirmed that it has complied with all Mega Rule requirements to date,[241] and is already recovering costs for Mega Rule compliance through base rates.[242]

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[237] Kollen Direct at 42; *see also* hearing cross-examination of Mr. Kollen, VTE, May 7, 2025 beginning at 9:26:20.
[238] Kollen Direct at 44 (*citing* Response to AG-DR-1-21, attached to Kollen Direct as Ex. LK-12). Mr. Kollen also testified that Mr. Kollen testified that the most effective means of recovering pipeline related costs is through base rates, because cost recovery through rider mechanisms incentivizes a company to spend more and take longer. Hearing cross examination of AG witness Kollen, VTE, May 7, 2025 beginning at 9:42:10.
[239] *Id.*
[240] Kollen Direct at 43. Mr. Kollen also points out that in response to the Commission's initial imposition of caps on PRP capital spending, the Company attempted to recover those costs in base rates, which the Commission denied. *Id.*
[241] Kollen Direct at 45 (*citing* Response to AG-DR-1-20, attached to Kollen Direct as Ex. LK-13).
[242] *See* hearing re-direct examination of AG witness Kollen beginning at 9:54:50.

Given the potential for cost and rate escalation, the Commission should deny the requested Rider PM.[243]

9. ANNUAL RATE REVIEW MECHANISM

Atmos continues to ask the Commission to consider an annual rate review mechanism, as it has in the last several rate cases, although it is not actually in the Company's application. The Company did not provide any details or a proposed tariff, but did cite generally to an annual review mechanism approved by the Tennessee Public Utility Commission. In Case No. 2017-00349, the Commisison rejected Atmos' request for an annual review mechanism (ARM), finding:

> "The Commission finds that the current ratemaking process is aligned with Kentucky statutes and regulations, ensures the public interest is served, and that it is fair to Atmos and its shareholders. The proposed ARM, while it may meet the needs of commissions in other jurisdictions, is not attractive in its offer of expediency or its relative guarantee of return. The Commission shares some of the concerns of the Attorney General with regard to lack of clear benefit to customers beyond that of a decrease in regulatory expense, and a predictable and possibly gradual annual increase in rates, the possibility of rate decreases notwithstanding. Moreover, to approve an annual ratemaking mechanism that could subsequently, and perhaps inevitably, be requested by and approved for 42 other gas and electric utilities and dozens of regulated water and sewer utilities, does not appear to provide benefits to the Commission, Commission Staff, intervenors, or consumers in terms of using scarce resources to produce reasonable outcomes. The Commission, therefore, finds that the proposed ARM tariff and mechanism should be denied."[244]

For these same reasons, the Commission should again reject the ARM, whether it is actually proposed or not.

10. TERMINATE RECOVERY OF DISCRETIONARY GTI GRANT FUNDING AND R&D RIDER

[243] Kollen Direct at 45.
[244] Case No. 2017-00349, Final Order dated May 3, 2018 at 36-37.

Atmos recovers approximately $300,000 from ratepayers annually through its R&D Rider, and passes these sums on to the Gas Technology Institute (GTI) in the form of grants to support GTI's research activities in Operations Technology Development (OTD) and Utilization Technology Development (UTD).[245] The Company states these grants support program and project management, research and development (R&D) work from applied research, field experiments and tests, and demonstration projects. GTI also works with manufacturers and others to transfer such R&D efforts into the marketplace so that they can be used by gas companies and gas consumers.[246] Finally, Atmos states that these grants to GTI will result in increased gas system safety, deliverability, integrity and O&M cost containment, and will result in gas customer savings, reduced gas use and bills, environmental benefits and enhance safety.[247]

It is inappropriate for ratepayers to finance such activities. As Mr. Kollen points out:

> "These are activities that should be funded directly by the suppliers to the industry and manufacturers of industry and end-use customer equipment and appliances, both for competitive advantage and through their industry research organizations for safety and other reasons. . . . There is no evidence there are direct benefits to the Company's customers other than the generalized benefits described by the Company resulting from its grant funding of certain OTD and UTD programs."[248]

11. RATE DESIGN

Atmos proposes to increase its residential monthly customer charge from the current $19.30 to $25.00, an increase of 29.5%. The Attorney General believes this increase would not be consistent with the principles of gradualism, which the Commission has been relying

[245] Response to Staff-DR-1-8.
[246] Kollen Direct at 48-49 (*citing* Response to Staff-DR-1-8).
[247] *Id.*
[248] *Id.* at 49.

on in setting customer charges. Instead, the Attorney General urges the Commission to reduce this proposal to $22.19, an increase of approximately 15%, which is more in line with the recent increases granted by the Commission.

III. CONCLUSION

WHEREFORE, the Attorney General respectfully requests that the Commission authorize the adjustments and approve the recommendations set forth in this brief and in the testimony of his three witnesses.

Respectfully submitted,

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Certificate of Service

Pursuant to the Commission's Order dated July 22, 2021 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.

This 30th day of May, 2025

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Assistant Attorney General