

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF ATMOS	)	CASE NO.
ENERGY CORPORATION FOR PERFORMANCE	)	2024-00205
BASED RATEMAKING MECHANISM	)	

ORDER

On August 30, 2024, Atmos Energy Corporation (Atmos) filed an application requesting the extension of its Performance-Based Ratemaking (PBR) mechanism and a motion requesting that its PBR mechanism be extended, without modification, for five years through May 31, 2030. As part of its application, Atmos included the utility's evaluation report. Additionally, Atmos referenced the annual reports it filed pursuant to the Commission's June 20, 2022 Order in Case No. 2020-00289, in which the Commission extended the Atmos PBR mechanism through May 31, 2025.<sup>1</sup>

On September 27, 2024, the Commission issued an Order establishing the procedural schedule in this case and suspending the tariff for further investigation. No parties requested intervention. On October 11, 2024 and November 8, 2024, Atmos filed responses to two rounds of requests for information from Commission Staff. Atmos subsequently requested a decision on the written record.<sup>2</sup> On April 11, 2025, Atmos filed

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<sup>1</sup> Case No. 2020-00289, *Electronic Application of Atmos Energy Corporation for Modification and Extension of its Gas Cost Adjustment Performance Based Ratemaking Mechanism* (Ky. PSC June 20, 2022), Order.

<sup>2</sup> Atmos' Motion to Submit (filed Jan 10, 2025).

notice that it would continue its PBR mechanism as proposed in this proceeding on June 1, 2025.<sup>3</sup> This matter is now before the Commission for a decision on the record.

### LEGAL STANDARD

Pursuant to KRS 278.040(2), the Commission has exclusive jurisdiction over the regulation of rates and services of utilities in Kentucky. Furthermore, under KRS 278.190(3), a utility bears the burden of proof to show that the proposed tariff is just and reasonable.

### BACKGROUND

The Commission approved Atmos's current PBR mechanism in Case No. 2020-00298, through May 31, 2025.<sup>4</sup> Atmos's PBR mechanism is broken into three parts: the Gas Acquisition Index Factor (GAIF), the Transportation Index Factor (TIF), and the Off-System Sales Index Factor (OSSIF).<sup>5</sup> Atmos's GAIF is broken into three component parts: the GAIF-Base Load (GAIFBL) measures base load gas costs against benchmarks; the GAIF-Swing Load (GAIFSL) measures swing load system supply costs against benchmarks; and the GAIF-Asset Management (GAIFAM) measures fixed discounts provided by the supplier for asset management rights, if any, not directly tied to per unit natural gas purchases.<sup>6</sup> The TIF component of Atmos's PBR mechanism is calculated by determining the difference between the benchmark demand and volumetric gas

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<sup>3</sup> Notice to Implement Rates (filed Apr. 11, 2025).

<sup>4</sup> Case No. 2020-00289, June 20, 2022 final Order.

<sup>5</sup> Atmos's Gas Tariff, P.S.C. KY No. 2, Third Revised Sheet No. 18.

<sup>6</sup> Atmos's Gas Tariff, P.S.C. KY No. 2, First Revised Sheet No. 19.

transportation costs and the actual demand and transportation costs.<sup>7</sup> The OSSIF in Atmos's PBR is simply the Net Revenue from Off-System Sales, which is calculated by taking the total revenue associated with off-system sales and storage service transactions and subtracting the out-of-pocket costs associated with off-system sales and storage transactions.<sup>8</sup>

For base load purchases within monthly firm commitments, GAIFBL benchmarks the cost of base load purchases against the average Inside FERC – Gas Market Report first-of-the-month posting for the area index associated the zones in which Atmos has firm transportation commitments and the New York Mercantile Exchange (NYMEX) Settled Closing Price.<sup>9</sup> For purchases in excess of firm monthly commitments, GAIFBL benchmarks the cost of base load purchases against the average of the Inside FERC – Gas Market Report first-of-the-month posting for the area index associated with the delivered supply and the NYMEX Settled Closing Price.<sup>10</sup> GAIFSL benchmarks the cost of swing load gas purchases against the mid-point Gas Daily posting associated with the supply area in which the swing load purchase is made.<sup>11</sup>

With respect to how the GAIFAM portion of the GAIF is calculated, Atmos's tariff states that the GAIFAM:

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<sup>7</sup> Atmos's Gas Tariff, P.S.C. KY No. 2, First Revised Sheet No. 26 – P.S.C. KY No. 2, First Revised Sheet No. 27.

<sup>8</sup> Atmos's Gas Tariff, P.S.C. KY No. 2, First Revised Sheet No. 27 – P.S.C. KY No. 2, First Revised Sheet No. 28.

<sup>9</sup> Atmos's Gas Tariff, P.S.C. KY No. 2, First Revised Sheet No. 27 – P.S.C. KY No. 2, First Revised Sheet No. 28.

<sup>10</sup> Atmos's Gas Tariff, P.S.C. KY No. 2, First Revised Sheet No. 22

<sup>11</sup> Atmos's Gas Tariff, P.S.C. KY No. 2, First Revised Sheet No. 23 – P.S.C. KY No. 2, First Revised Sheet No. 24.

[R]epresents the Gas Acquisition Index Factor for Asset Management, representing the portion of fixed discounts provided by the supplier for asset management rights, if any, not directly tied to per unit natural gas purchases.<sup>12</sup>

The GAIFAM was approved in Case No. 2005-00321 to allow the inclusion of gas cost savings represented by a fixed annual discount that could be provided by the winning bidder for Atmos' asset management contract. The savings in this instance would take the place of savings calculated using comparison of actual to benchmarked gas cost. The inclusion of the GAIFAM was requested by Atmos to give prospective asset management bidders more options in constructing their bids in response to Atmos' Requests for Proposal.<sup>13</sup>

Variances between Atmos's actual costs and the benchmarks are shared between shareholders and ratepayers on a sliding scale consisting of two bands. The first band covers variances ranging from 0 to 9.4 percent of Atmos's actual gas costs will be shared 70 percent to ratepayers and 30 percent to shareholders. The second band covers variances greater than 9.4 percent and is shared 50/50 between ratepayers and shareholders.<sup>14</sup> The Commission adjusted Atmos's sharing band in Case No. 2020-00289 from 2 percent to 9.4 percent, finding that, Atmos will continue to receive at least 30 percent of PBR savings to encourage savings behavior and will have additional incentives to further improve gas cost savings beyond current levels. More importantly, the Commission found that the adjustment to the sharing band should also allow the

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<sup>12</sup> Atmos' Gas Tariff, P.S.C. KY No. 2, First Revised Sheet No. 19.

<sup>13</sup> Case No. 2005-00321, *Modifications of Atmos Energy Corporation's Gas Cost Adjustment To Incorporate Performance Based Ratemaking Mechanism* (Ky. PSC Feb. 8, 2006), final Order.

<sup>14</sup> Atmos' Gas Tariff, P.S.C. KY No. 2, Second Revised Sheet No. 29.

Commission to monitor the effects, if any, of reducing the incentives offered under the mechanism without risking unforeseen consequences of eliminating the PBR mechanism outright.<sup>15</sup> The adjustment to the band become effective as of June 20, 2022.

Atmos asserted that its PBR mechanism provides a mix of incentives and penalties that encourage it to test new ways to purchase gas supplies and to negotiate transportation contracts in order to generate shared savings.<sup>16</sup> Specifically, Atmos stated that the PBR mechanism induced it to develop a contract model and request for proposal (RFP) process that it contended results in significantly discounted bids for commodity gas.<sup>17</sup> Atmos similarly indicated that the PBR mechanism encouraged it to generate pipeline demand savings through the receipt of segmented demand from another Atmos Division and to aggressively use alternative pipeline suppliers as a bargaining tool to negotiate meaningful discounts in transportation contracts.<sup>18</sup>

Atmos reported savings of \$3,595,306.21 for the 2020/2021 year; \$3,463,813.23 for the 2021/2022 year; and \$2,892,156.57 for the 2022/2023 year.<sup>19</sup> Atmos stated that its total measurable gas purchase savings attributable to the PBR program for the period from June 2020 through May 2024 was approximately \$33.9 million, and a majority of those savings have gone to its customers.<sup>20</sup> Atmos stated that the PBR benchmarks represent the reasonable and prudent cost of gas. Atmos further indicated that the PBR

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<sup>15</sup> Case No. 2020-00289, June 20, 2022 final Order.

<sup>16</sup> Atmos' PBR Application at Exhibit B, page 15 of 25.

<sup>17</sup> Atmos' PBR Application at Exhibit B, page 10 of 25.

<sup>18</sup> Atmos' PBR Application at Exhibit B, pages 12 of 25 and 13 of 25.

<sup>19</sup> Atmos' PBR Application at Exhibit A.

<sup>20</sup> Atmos' PBR Application at Exhibit B, page 14 of 25.

savings are evidence that the actions it was induced to take by the PBR mechanism resulted in lower gas costs for customers.<sup>21</sup> Atmos requested that its PBR mechanism be extended for a period of five years without modification through May 31, 2030.<sup>22</sup>

### DISCUSSION

Cost-based rates for investor-owned utilities are set at a level to allow the utility to recover all its reasonable expenses and provide its shareholders an opportunity to earn a fair return on invested capital.<sup>23</sup> The Kentucky Local Distribution Companies' (LDCs) Gas Cost Recovery (GCR) mechanisms provide for full recovery of the actual cost of gas, with the LDC retaining no profit and sustaining no financial losses on gas purchase transactions. The significance of Atmos's PBR mechanism is that it allows Atmos to recover not only the actual gas costs incurred, but also a portion of calculated savings if gas costs are lower than defined benchmarks. It requires Atmos to return to its customers a portion of calculated losses if gas costs exceed the benchmarks. The goal of the PBR mechanism is to reduce the overall rates paid by Atmos's customers, while maintaining supply reliability, by incentivizing Atmos to obtain gas from a reliable source at the lowest cost.

If the PBR mechanism does not result in lower customer costs than would have otherwise been paid in the absence of the PBR mechanism, then the PBR mechanism

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<sup>21</sup> Atmos' PBR Application at Exhibit B, at 15 of 25.

<sup>22</sup> Atmos' PBR Application at 2 of 25.

<sup>23</sup> Case No. 2017-00481, *An Investigation of the Impact of the Tax Cuts and Job Act on the Rates of Atmos Energy Corporation, Delta Natural Gas Company, Inc., Columbia Gas of Kentucky, Inc., Kentucky American Water Company, and Water Service Corporation of Kentucky* (Ky. PSC Dec. 27, 2017), Order at 1–2; see also *Com. ex. rel. Stephens v. South Central Bell Tel. Co.*, 545 S.W.2d 927, 931 (Ky. 1976) ("Rates are non-confiscatory, just and reasonable so long as they enable the utility to operate successfully, to maintain its financial integrity, to attract capital and to compensate its investors for the risks assumed.").

would not serve its intended purpose and, therefore, would not be justified. Further, using the PBR mechanism to share savings that Atmos would have otherwise realized in the absence of the PBR mechanism would not be justified by the purpose of the mechanism. In fact, even savings arising from the PBR mechanism should only be shared with the utility to the extent necessary to incentivize the desired behavior. Additional excessive sharing of gas cost savings would not serve the purpose of the PBR mechanism and would not be reasonable.

Atmos argued that the PBR mechanism has incentives and penalties that encourage it to generate gas cost savings and that its PBR savings demonstrate that it actually has generated savings as compared to the market. The Commission agrees that the ability to share in the PBR savings provides an incentive for Atmos to generate savings as compared to benchmarks and that Atmos has been able to beat prices paid by others for both gas and transportation services. Thus, there is sufficient evidence to support the argument that Atmos's PBR mechanism actually results in savings for customers.

However, Atmos, like the other LDCs, appears to have trouble establishing whether, and the extent to which, the incentives offered by the PBR mechanism actually result in the PBR savings recorded. Certain savings likely arise from a utility's position in the market, such as its ability to obtain multiple bids for large, long-term gas supply contracts at indexed prices below the first of the month prices or its ability to use storage assets funded by customers to obtain gas when prices are more favorable. A utility would also have at least some incentive to take advantage of opportunities in the market to reduce gas costs below benchmark prices even if the PBR mechanism were eliminated,

because the Commission has the authority to review and disallow gas costs that are found to be unreasonable. Further, even if Atmos's PBR mechanism encourages cost saving behavior, the PBR mechanism would only serve its purpose of reducing customer costs if the amount of the actual savings for customers generated by the change in behavior exceeded Atmos's share of any savings that preexisted the PBR mechanism.<sup>24</sup> Thus, the fact that the PBR mechanism provides an incentive and Atmos does obtain gas and transportation services below costs paid by others does not necessarily establish that the PBR mechanism results in savings for customers. Similar to the findings in Case No. 2020-00289, the Commission does not believe that it would be prudent to simply eliminate Atmos's PBR mechanism in its entirety at this time due to potential unforeseen effects on customer costs.<sup>25</sup>

Having reviewed the evidence of the record and being otherwise sufficiently advised, the Commission finds that Atmos's PBR mechanism should be extended, without modifications, through March 31, 2027. The Commission finds March 31, 2027, to be an appropriate extension allowing the Commission to more thoroughly review the impact of the reduced sharing band as ordered in Case No. 2020-00289, effective as of June 2022. Furthermore, the Commission notes that previous Orders in this case permitted Atmos to keep the PBR mechanism in place, without modification, until a final Order was entered in this matter. Atmos' PBR mechanism has remained active for the entirety of this proceeding.

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<sup>24</sup> See, e.g. Case No. 2020-00378, *Electronic Application of Columbia Gas of Kentucky, Inc. to Extend its Gas Cost Incentive Adjustment Performance Based Ratemaking Mechanism* (Ky. PSC June 15, 2022), Order at 8–9 (discussing how sharing savings that preexisted the PBR mechanism could raise customer costs if it exceeded customer savings generated by the mechanism).

<sup>25</sup> Case No. 2020-00289, June 20, 2022 final Order, at 10.



In future PBR cases, the Commission will continue to evaluate Atmos's PBR mechanism for reasonableness, and the Commission may realign, modify, or terminate the PBR mechanism. The Commission notes that the burden is on the utility to submit sufficient and necessary information into the record to establish that any proposed extension or modification is reasonable. Therefore, in Atmos's next PBR case, Atmos should file testimony and any supporting documentation to support a finding that Atmos's PBR mechanism assists in creating fair, just and reasonable rates. Atmos should be prepared to discuss the benchmarks and PBR components at length and provide quantifiable evidence to support the benefit of the PBR mechanism, including a discussion of the effects, if any, of modifications to the PBR mechanism in this case and Atmos's last PBR case.

Pursuant to its Tariff, Atmos is required to file annual reports of its activities under the PBR program by August 31<sup>st</sup> of each year.<sup>26</sup> Atmos also updates its PBR rate for its utility share portion of the savings annually in its GCR rate report filing for rates effective in February of each year.<sup>27</sup> Included as Exhibit A and Exhibit B in its PBR renewal application, Atmos provided a PBR Summary Schedule for the period June 2023 through May 2024 and a PBR Summary Schedule for the period June 2020 through May 2024, respectively. The Commission finds that, when Atmos files these future reports, it should include additional supplemental information that provides a monthly breakdown of the costs or savings for each basic component of its PBR. Atmos should also provide information regarding the benchmarks used and the costs associated with the gas costs

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<sup>26</sup> Atmos' Gas Tariff, P.S.C. KY No. 2, Second Revised Sheet No. 29.

<sup>27</sup> The most recent example of this is in Case No. 2024-00391, *Electronic Purchased Gas Adjustment Filing Of Atmos Energy Corporation* (filed. Dec. 30, 2024), Exhibit E and PBR Workpaper 1.

used against such benchmarks. Furthermore, when filing its future PBR reports, Atmos should file a version in Excel spreadsheet format, with all formulas, columns, and rows unprotected and fully accessible. The Commission notes that to facilitate the timely processing and review of these filings, Atmos should strive to clearly provide the necessary information and explain the origin of the values as reported.

IT IS THEREFORE ORDERED that:

1. The continuation of Atmos' PBR mechanism is approved and effective on the date of this Order through March 31, 2027.<sup>28</sup>

2. In the next PBR case, Atmos shall file an evaluation report on the results of the PBR from April 1, 2021, through the most recent month available at the time of filing, for the Commission to review and determine whether the PBR should be continued, modified, or terminated. This evaluation report shall be considered in any proceeding established to continue, modify, or terminate the PBR mechanism.

3. In the next PBR case, Atmos shall also file testimony and any supporting documentation to assist the Commission in determining whether Atmos's PBR should be continued, modified, or terminated.

4. Any request for extension of Atmos's PBR shall be filed no less than four months before the March 31, 2027, expiration date.

5. When filing its future PBR reports, Atmos shall provide additional supplemental information of the information presented along with a monthly breakdown of the costs or savings for each basic component of its PBR. Atmos shall also provide

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<sup>28</sup> Previous Orders allowed the mechanism to remain effective without modification pending this Order.

information regarding the benchmarks used and the costs associated with the gas costs used against such benchmarks.

6. When filing its future PBR reports, Atmos shall file a version in Excel spreadsheet format, with all formulas, columns, and rows unprotected and fully accessible.

7. Within 20 days of the date of this Order, Atmos shall file with this Commission, using the Commission's electronic Tariff Filing System, revised tariff sheets setting out the PBR dates approved herein, and reflecting that they were approved pursuant to this Order.

8. This case is closed and removed from the Commission's docket.

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