



RAILROAD COMMISSION OF TEXAS

OFFICE OF GENERAL COUNSEL

GUD NO. 10000

STATEMENT OF INTENT TO CHANGE THE RATE CGS AND RATE PT RATES OF ATMOS PIPELINE – TEXAS

APPEARANCES

FOR APPLICANT

Ann M. Coffin, Dane McKaughan
Parsley Coffin Renner LLP
98 San Jacinto Blvd., Ste 1450
Austin, Texas 78711

ATMOS CITIES STEERING COMMITTEE (ACSC)

Geoffrey M. Gay, Georgia N. Crump, Eileen McPhee
Lloyd Gosselink Rochelle & Townsend, P.C.
P.O. Box 1725
Austin, Texas 78767

ATMOS TEXAS MUNICIPALITIES (ATM)

Alfred R. Herrera, Jim Boyle, Felipe Alonso III, Carrie R. Tourillon
Herrera & Boyle, PLLC
816 Congress Avenue, Suite 1250
Austin, Texas 78701

THE CITY OF DALLAS

Peter Haskel, Don Knight
Assistant City Attorneys, City of Dallas

Norman J. Gordon, Steven L. Hughes
Mounce, Green, Myers, Safi, Paxon & Galatzan
100 N. Stanton Street, Suite 1000
El Paso, Texas 79901

THE STATE OF TEXAS

Larry C. Buch, Assistant Attorney General
Office of the Attorney General
Public Agency Representation Section
300 W. 15th Street
Austin, Texas 78701

RAILROAD COMMISSION OF TEXAS (Staff)

John Pierce Griffin, Assistant Director of Appellate Law
Railroad Commission of Texas
1701 N. Congress
P.O. Box 12967
Austin, Texas 78711-2967

INDUSTRIAL GAS USERS (IGU)

James M. Bushee, James E. Guy, Alicia Rigler, Paul F. Forshay
Southerland Asbill & Brennan LLP
701 Brazos St., Suite 970
Austin, Texas 78701

COSERV

John Hays
Hays & Owens, L.L.P.
807 Brazos Street, Suite 500
Austin, Texas 78701

FOWLER ENERGY COMPANY

P.D. Leonard, Senior Vice President
4520 Spicewood Springs Road
Austin, Texas 78759

PROPOSAL FOR DECISION**PROCEDURAL HISTORY:**

Docket Established:	September 17, 2010
Final Hearing Dates:	January 24 – 27, 2011
Heard By:	Gene Montes, Hearings Examiner Mark Brock, Technical Examiner
Record Closed:	March 16, 2011
PFD Circulation:	March 17, 2011
PFD (Corrected):	April 11, 2011

STATEMENT OF THE CASE

In this proceeding Atmos Pipeline – Texas requested an overall revenue requirement, offset by revenues derived from service provided to non-regulated customers, of \$155,703,729. The Examiners find the company has established that a revenue requirement of \$143,049,141, offset by revenues derived from service provided to non-regulated customers, is just and reasonable. This results in an overall increase to the company's revenues of \$26,150,965.

The company has established that the cost of providing service to the regulated customers is, in fact, \$226,763,998. Due to application of a credit for other revenues from non-regulated customers in the amount of \$83,723,391.63 (referred to herein as "Other Revenue") the revenue requirement established in this proceeding is \$143,049,141. The rates required to recover the revenue requirement of \$226,763,998 are set forth in Table A, below. They are compared to the rates required to recover the revenue requirement once the Other Revenue credit is applied.

Table A
Comparison of Rates with Revenue Credit and without Revenue Credit

	Recover Cost of Service to Regulated Customers without Revenue Credit \$226,763,998	Recover Cost of Service to Regulated Customers with Revenue Credit \$143,049,141
	(A)	(B)
Rate CGS – Mid-Tex		
Capacity Charge per MDQ	-	--
Mid-Tex WGIS Charge	6.2984	3.6263
Usage Charge per MMBtu	0.8133	0.8133
	0.0276	0.0276
Rate CGS – CoServ		
Capacity Charge per MDQ	-	-
Usage Charge per MMBtu	6.2984	3.6263
	0.0276	0.0276
Rate CGS – City of Rising Star and West Texas Gas		
Capacity Charge per MDQ	-	-
Usage Charge per MMBtu	6.2984	3.6263
	0.0276	0.0276
Rate PT		
Capacity Charge	4.0732	2.3061
Usage Charge per MMBtu	0.0163	0.0163

The Examiners recommend that eight adjustments be made to the company's request in this case:

- Removal of certain items in utility plant in service: Artwork, Mississippi Billing System, Meals over \$25, lodging over \$150
- Prepayments: Removal of Advance Payment
- Create a Reserve for FAS 106
- CWC: Adjustment to Revenue Lag based upon recommendation to approve Rider Rev
- Adjustment to Other Revenue calculation for retention gas adjustment
- Reject adjustment to test-year labor calculation
- Adjustment for Atmos Pipeline – Texas labor expenses charged to other divisions
- Adoption of a return on equity of 11.80% instead of 12.75%
- Certain adjustments to the proposed Rider Rev

As part of this proceeding the Commission has been asked to review the investments included in the last seven interim rate adjustment filings (GRIP). The Examiners find that except in five instances Atmos Pipeline - Texas has established that those investments are just and reasonable. The Examiners recommend a refund of \$1,097,601. The refund is the result of an over collection of *Ad Valorem* Taxes from 2005 through 2009.

In all other respects the Examiners recommend approval of the requested rates, allocation, and rate design as Atmos Pipeline – Texas has established that they result in rates that are just and reasonable.

The following documents are attached to this Proposal for Decision:

- Map of Atmos Energy Pipeline System and Competitive Pipelines, Attachment 1
- *Ad Valorem* Tax Refund Schedule, Attachment 2
- Examiners' GRIP Refund Schedule 1, Attachment 3
- Examiners' Model, Decision Summary, and Recommendation, Attachment 4

1. Procedural History

On September 17, 2010, Atmos Pipeline – Texas filed a *Statement of Intent* to increase rates with the Railroad Commission of Texas (Commission). The case was docketed as GUD No. 10000. The proposed rates were suspended on October 12, 2010. Notice of the proposed increase was provided by mailing to each applicable Rate PT and Rate CGS customer served from the pipeline system at their billing address by certified mail, postage paid on September 24, 2010 and publishing the notice each week for four successive weeks, beginning the week of September 26, 2010 and running through the week of October 24, 2010, in a newspaper having a general circulation in each county containing territory affected by the proposed increase.¹

The following entities intervened in this proceeding: The Atmos Cities' Steering Committee ("ACSC") representing Abilene, Addison, Allen, Alvarado, Angus, Anna, Argyle, Arlington, Bedford, Bellmead, Benbrook, Beverly Hills, Blossom, Blue Ridge, Bowie, Boyd, Bridgeport, Brownwood, Buffalo, Burkburnett, Burleson, Caddo Mills, Carrollton, Cedar Hill, Celeste, Celina, Cisco, Cleburne, Clyde, College Station, Colleyville, Colorado City, Comanche, Coolidge, Coppell, Corinth, Corral City, Crandall, Crowley, Dalworthington Gardens, Denison, DeSoto, Duncanville, Eastland, Edgecliff Village, Emory, Ennis, Euless, Everman, Fairview, Farmers Branch, Farmersville, Fate, Flower Mound, Forest Hill, Fort Worth, Frisco, Frost, Gainesville, Garrett, Garland, Grand Prairie, Grapevine, Haltom City, Harker Heights, Haslet, Hewitt, Highland Park, Highland Village, Honey Grove, Hurst, Iowa Park, Irving, Justin, Kaufman, Keene, Keller, Kemp, Kennedale, Kerrville, Killeen, Krum, Lakeside, Lake Worth, Lancaster, Lewisville, Lincoln Park, Little Elm, Lorena, Madisonville, Malakoff, Mansfield, McKinney, Melissa, Mesquite, Midlothian, Murphy, Nacona, North Richland Hills, Northlake, Oak Leaf, Ovilla, Palestine, Pantego, Paris, Parker, Pecan Hill, Plano, Ponder, Pottsboro, Prosper, Quitman, Reno (Parker County), Red Oak, Richardson, Richland, Richland Hills, River Oaks, Roanoke, Robinson, Rockwall, Roscoe, Rowlett, Royce City, Sachse, Saginaw, Seagoville, Sherman, Snyder, Southlake, Springtown, Stamford, Stephenville, Sulphur Springs, Sweetwater, Temple, Terrell, The Colony, Tyler, University Park, Venus, Vernon, Waco, Watauga, Waxahachie, Westlake, Whitesboro, White Settlement, Wichita Falls, Woodway, and Wylie; the Atmos Texas Municipalities ("ATM") representing Austin, Balch Springs, Bandera, Barlett, Belton, Blooming Grove, Bryan, Cameron, Cedar Park, Clifton, Commerce, Copperas, Cove, Corsicana, Denton, Electra, Fredericksburg, Gatesville, Georgetown, Goldwaite, Granbury, Greenville, Groesbeck, Hamilton, Henrietta, Hickory Creek, Hico, Hillsboro, Hutto, Kerens, Lampass, Leander, Lometa, Longview, Mart, Mexia, Olney, Pflugerville, Ranger, Rice, Riesel, Rogers, Roundrock, San Angelo, Sanger, Somerville, Star Harbor, Trinidad, Trophy Club, Whitney; the **City of Dallas**; CoServ Gas, Ltd. ("Coserv"); the State of Texas ("**State**") and Staff of the Railroad Commission ("**Staff**"); the Industrial Gas Users ("**IGU**") representing large industrial gas users that receive natural gas service from Atmos Pipeline – Texas, and **Fowler Energy**.

The hearing in this matter commenced on January 24, 2011, and was concluded on January 28, 2011. The following individuals testified on behalf of Atmos in its direct case: Richard A. Erskine, President of Atmos Pipeline-Texas, Barbara W. Myers, Regulatory Accounting Manager of Atmos Energy Corporation, Thomas H. Petersen, Rates Director of Atmos Energy Corporation, Robert Hevert, Concentric Energy Advisors, Inc.; J. Stephen

¹ Atmos Exhibit 4, Affidavit of Publication from Charles R. Yarbrough II.

Gaske, Concentric Energy Advisors, Inc., Jeffrey S. Knights, Vice-President of Operations in the Mid-Tex Division of Atmos Energy Corporation, Dane Watson, Alliance Consulting, and John J. Reed, Concentric Energy Advisors. The City of Dallas presented the following witnesses: Jacob Pous, Diversified Utility Consultants, Inc. (DUCI); Daniel J. Lawton, DUCI; and Sara Coleman, DUCI. The following individuals testified on behalf of the Atmos Texas Municipalities: Steven C. Carver, Utilitech, Inc., David Parcell, President, Technical Associates, Inc. and Michael L. Brosch, Utilitech, Inc. ACSC presented the following witnesses: Karl J. Nalepa, R.J. Covington Consulting, LLC.; Constance T. Cannady, J. Stowe & Co., LLC; and J. Randall Woolridge, Professor Pennsylvania State University, Staff of the Railroad Commission offered testimony from Rose A. Ruiz, Utility Analyst; Frank M. Tomicek, Utility Specialist; and, Lynne M. LeMon, Utility Analyst. Rebuttal testimony was provided for Atmos by the following individuals: John J. Reed, J. Stephen Gaske, Richard A. Erskine, Dereck Boyd, Director of Risk Management, Atmos Energy Corporation, Pace McDonald, Director of Taxes, Thomas H. Peterson, Jeffrey S. Knights, Dane A. Watson, and Robert Hevert.

2. Jurisdiction

The Commission has jurisdiction over Atmos Pipeline – Texas and over the matters at issue in this proceeding pursuant to *Tex. Util. Code Ann.* §§ 102.001, 103.003, 103.051, 104.001, 121.051, 121.052, and 121.151 (Vernon 2008). The statutes and rules involved in this proceeding include, but are not limited to *Tex. Util. Code Ann.* §§ 104.101, 104.102, 104.103, 104.105, 104.106, 104.107, 104.110, 104.301, and 16 *Tex. Admin. Code* Chapter 7.

3. Atmos Pipeline – Texas

Atmos Energy Corporation is engaged in the regulated natural gas distribution, transmission and storage businesses, as well as other non-regulated natural gas businesses. Throughout its various service territories, Atmos Energy directly employees approximately 4,900 people and distributes natural gas through regulated sales and transportation arrangements to over three million customers in twelve states. Through its unincorporated division, Atmos Pipeline-Texas, the applicant in this proceeding, Atmos Energy Corporation operates one of the largest intrastate pipelines in Texas.²

Atmos Pipeline – Texas is an unincorporated division of Atmos Energy Corporation and is an intrastate natural gas transmission pipeline operating solely in Texas. Atmos Pipeline – Texas operates a large intrastate pipeline consisting of approximately 6,000 miles of transmission pipeline, approximately 700 city gate meters, five underground storage facilities, and forty-one (41) gas compressor stations. The geographical areas served by this pipeline division spans from the area bounded by the Oklahoma border; the Katy hub near Houston; the Carthage hub in East Texas; the Waha hub in West Texas; and the Austin/Hill Country area. A map of the system is attached to this Proposal for Decision.³

Atmos Pipeline – Texas employs approximately sixty (60) individuals, primarily in the areas of gas control, transportation services, industrial marketing and executive management.

² Atmos Ex. 6, Direct Testimony of Richard A. Erskine, p. 8, lns. 9 – 18.

³ Atmos Ex. 6, Direct Testimony of Richard A. Erskine, p. 8, ln. 20 – p. 9, ln. 15.

The division utilizes the shared services organization of Atmos Energy Corporation for administrative support functions, such as accounting, information technology, regulatory, legal and billing. The division also uses the operational organization of Atmos Mid – Tex, another operational division of Atmos Energy Corporation, to design, construct, operate and maintain the pipeline and storage system.⁴

Atmos Pipeline – Texas provides service to three customer classes. First, Atmos Pipeline – Texas provides transportation and storage service to the local distribution companies (LDC). These include Atmos Mid – Tex, CoServ, the City of Rising Star, and West Texas Gas. The customers in this group are served pursuant to two tariffs: Rate CGS Mid-Tex and Rate CGS Other. Second, the company provides service to on-system industrial system customers. These customers are directly served by Atmos Pipeline – Texas. The customers in this class are served pursuant to the PT-Pipeline Transportation Tariff. These are interruptible customers and are under cost of service rates set by the Commission because they do not have viable competitive alternatives to Atmos Pipeline – Texas. Third, Atmos Pipeline-Texas provides services to certain industrial customers, electric generation customers, producers and marketer transportation customers (also referred to as through-system deliveries) that are served under negotiated rates. Atmos Pipeline – Texas also provides ancillary services to producers and marketers, such as storage. The third category of customers in this filing is the Other Revenue segment.⁵ The rates paid by these customers are negotiated rates and are not being set in this proceeding.

The LDC customers served pursuant to the Rate CGS accounted for 51% of the total revenues during the test-year. These customers account for approximately 31% of the volume during the same period. The industrial customers served pursuant to the Rate PT tariff made up 4% of the revenues during the test year and 3% of the total volumes. Finally, the customers that make up the Other Revenue segment served pursuant to negotiated rates accounted for 41% of the total revenues during the test year and 66% of the volumes.⁶ Table 3.1 below provides a summary of the three customer classes.

Table 3.1
Characteristics of Atmos Pipeline – Texas Customer Classes

	LDC	Industrial	Other Revenue Segment
Representative Examples	Atmos Mid-Tex, CoServ, City of Rising Star, and West Texas Gas	Directly served by Atmos Pipeline – Texas	Industrial, Electric Generation, producers and marketers.
Rate	CGS	PT-Pipeline Transportation	Negotiated Rates
Test-Year Revenues	51%	4%	45%
Test-Year Volumes	31%	3%	66%

4. Books and Records

⁴ Atmos Ex. 6, Direct Testimony of Richard A. Erskine, p. 9, lns. 9 – 15.

⁵ Atmos Ex. 6, Direct Testimony of Richard A. Erskine, p. 10, ln. 4 – p. 12, ln. 7.

⁶ Atmos Ex. 14, Direct Testimony of John J. Reed, p. 6, ln. 16 – p. 7, ln. 17.

Commission Rule 7.310 requires that utilities utilize the FERC USOA.⁷ Barbara Myers, the Regulatory Accounting Manager of Atmos Energy Corporation, affirmed that the books and records are kept in accordance with the Federal Energy Regulatory Commission ("FERC") Uniform System of Accounts ("USOA"). Ms. Myers provided detailed testimony outlining the accounting process and affirmed that the company complied with the requirement of the FERC USOA. She asserted that the company's system of internal controls and its adherence to FERC USOA assured compliance with Commission Rule 7.310.⁸ As a result, Ms. Myers concluded that the company is entitled to the presumption encapsulated in Commission Rule 7.503.⁹ That rule provides that the amounts shown on the company's books and records as well as summaries and excerpts taken from those records shall be considered *prima facie* evidence of the amount of investment or expense reflected when introduced into evidence, and such amounts are presumed to have been reasonably incurred. The Examiners find that Atmos Pipeline – Texas has established that the company maintains its books and records in accordance with FERC USOA. Accordingly, the books and records are accorded the presumption found in Commission Rule 7.503.

5. Overview of Merger of TXU and Atmos Energy Corp. – Public Interest Analysis

Effective October 1, 2004, Atmos Energy Corporation, through a series of mergers, acquired the assets and liabilities of TXU Gas Company (TXU Gas). Atmos Energy formed LSG Acquisition Corporation (LSG) and merged TXU Gas into LSG, both entities surviving. Immediately after the merger, LSG merged with and into Atmos Energy, with Atmos Energy surviving. The assets included all of the natural gas pipeline transmission, distribution and storage assets of TXU Gas, together with all real property, personal property, contract rights, licenses, permits, franchises, computer software and all other property rights and interests.¹⁰

The assets included approximately 26,400 miles of intrastate distribution pipeline, 6,100 miles of transmission pipeline and five natural gas storage facilities with a working capacity of 38 Bcf. The pipeline and storage facilities held by TXU Gas were then held by Atmos Pipeline – Texas and the distribution assets held by TXU Gas were then held by Atmos Mid – Tex, both unincorporated divisions of Atmos Energy Corporation. The acquisition transaction was Atmos Energy's largest acquisition, which doubled the size of Atmos Energy.

Atmos Energy notified the Railroad Commission of Texas of the transaction on November 22, 2004. The Commission docketed the matter as GUD No. 9555, *Application for Review of the Merger between Atmos Energy Corporation and TXU Gas Company, L.P.* Through a series of questions asked of utilities under Texas Utilities Code § 102.051, Atmos provided information which the Commission retained on file for future consideration in a rate making proceeding.¹¹

⁷ TEX. ADMIN. CODE § 7.310 (Tex. R.R. Comm'n, System of Accounts) (Commission Rule 7.310).

⁸ Atmos Ex. 6, Direct Testimony of Barbara W. Myers, p. 9, ln.1 – p. 18, ln 10.

⁹ Atmos Ex. 18, Direct Testimony of Barbara W. Myers, p. 18, lns. 10 – 22. TEX. ADMIN. CODE § 7.501 (Tex. R.R. Comm'n, Evidentiary Treatment of Uncontroverted Books and Records of Gas Utilities) (Commission Rule 7.503).

¹⁰ Atmos Ex. 6, Direct Testimony of Richard A. Erskine, Exhibit RAE-3.

¹¹ GUD No. 9555, November 20, 2005, correspondence from the Commission.

The statute provides that in order to make the public interest determination the Commission must consider the reasonable value of the property, facilities, or securities to be acquired, disposed of, merged, or consolidated. Atmos Mid-Tex argued that outside of its plain meaning, there is little guidance in Texas law about the public interest standard in GURA. The Company argued that FERC utilizes a similar transaction approval standard in Section 203(a) of the Federal Power Act.¹² That standard has been interpreted to mean that the utility need not demonstrate that the transaction “positively benefits the public interest, but rather that it is ‘consistent with the public interest’, i.e., that the transaction does not harm the public interest.”¹³ GURA section 102.051, provides as follows:

On filing of a report with the railroad commission, the railroad commission shall investigate the transaction . . . and determine whether the action is consistent with the public interest. In reaching its determination, the railroad commission shall consider the reasonable value of property, facilities, or securities to be acquired, disposed of, merged, or consolidated.¹⁴

As noted by Mr. Erskine, the Commission has previously considered the acquisition of TXU Gas Company by Atmos Energy Corporation. He correctly noted that in Finding of Fact No. 168 in the Final Order in GUD No. 9670, the Commission found “. . . the merger between Atmos Mid – Tex and TXU Gas was consistent with the public interest.” As he noted, this Finding of Fact addressed the same transaction in which the transmission pipeline assets of TXU Gas Company were acquired by Atmos Energy. Mr. Erskine noted that Atmos Energy has invested significant capital in the Atmos Pipeline-Texas systems subsequent to the acquisition and that Atmos Energy’s investment in the pipeline division since the merger has totaled almost \$482 million. The investment included both pipeline and storage facilities.¹⁵

6. Interim Rate Adjustment (GRIP) – Overview and Procedural History

In 2003, amended in 2005 in the 79th legislative session, the 78th legislature provided the utilities a mechanism to adjust their rates with an interim adjustment for capital investment. Prior to this statute, the only way a utility could increase its rates was to file a full-blown rate case. Key workings of the GRIP statute provided for an interim adjustment to a utility’s rates if the utility met certain criteria. Among other key requirements, the utility had to have a rate case within two years of the initial filing,¹⁶ which provides the benchmark factors, and must file a rate case within 180 days of the fifth anniversary of the effective date of the initial filing.¹⁷ The utility had to use the same factors of return on investment, depreciation expense, *ad valorem* taxes, revenue related taxes and incremental federal income taxes that was determined in the last

¹² 16 U.S.C. § 824b(a).

¹³ Texas-New Mexico Power Co., 105 FERC 61,028 at p. 23 n. 14 (2003)

¹⁴ Tex. Util. Code Ann. § 102.051(b).

¹⁵ Atmos Ex. 6, Direct Testimony of Richard A. Erskine, p. 15, lns. 13 – 16, ln. 17. Citing to Tex. R.R. Comm’n, *Petition for DeNovo Review of the Reduction of the Gas Utility Rates of Atmos Energy Corp., Mid-Tex Division, by the Cities of Blue Ridge, Caddo Mills et al.; Atmos Energy Corporation Statement of Intent to Change Rates in the Atmos Energy Corp., Mid-Tex Division Gas Utility System, Petition for Review from the Actions of Municipalities*, Docket No. 9670 (Gas Utils. Div. June 17, 2007)(Order On Rehearing).

¹⁶ TEX. UTIL. CODE §104.301(a).

¹⁷ TEX. UTIL. CODE §104.301(h).

rate case.¹⁸ Once a utility files its first Interim Rate Adjustment (IRA) filing, it is required to file an IRA filing annually and file a statement of intent after the fifth anniversary.¹⁹ One key provision of the statute is the IRA is subject to refund. Once the utility files a rate case subsequent to that IRA filing and the issuance of a final order or decision by a regulatory authority is made, all amounts collected are no longer subject to refund.²⁰ In other words, once the Commission issues a final order in this docket, the revenue Atmos Pipeline – Texas received from the interim rate adjustments from capital investment will no longer be subject to refund. Additional discussion regarding the GRIP Statute and its interpretations follow.

a. Interim Rate Adjustments (IRA)

The Commission rule regarding IRA filings provided additional guidance to the utilities filing IRAs under the GRIP statute. The rule,²¹ adopted December 27, 2004, provided specific instructions for the notice, contents of the application, annual project report, annual earnings monitoring report, procedure for review, and reimbursement for administrative costs of review. Atmos Pipeline – Texas seeks a finding from the Commission that the investments Atmos Pipeline – Texas has made from 2003 to 2009, as well as the investments from January 1, 2010 to March 31, 2010, were prudent and necessary.²²

In 2003, the 78th Legislature changed the way a utility may adjust its approved rates by allowing utilities to make an interim adjustment to its rates for capital investment.²³ In summary, a utility that has filed a rate case under Subchapter C within the preceding two years may file for an IRA.²⁴ The IRA adjusts the approved rate set in the last rate case for the utility. Upon initiating an IRA, the utility must file a rate case under Subchapter C before the fifth anniversary of the date on which the rate schedule of the first IRA takes effect. As noted above, all investments included in prior filings are subject to refund, Atmos Pipeline – Texas made seven IRA filings between GUD No. 9400²⁵ and this docket, GUD No. 10000. All entries in those filings are subject to refund.

Atmos Pipeline – Texas filed its first IRA under the GRIP statute in December 2004 with an effective date of March 2005. Atmos Pipeline – Texas filed six more IRA applications under the GRIP Statute and Commission Rule.²⁶ The significance of reviewing each of the seven IRA filings made by Atmos Pipeline – Texas is that each filing included hundreds of projects with thousands of documents to support the projects in its applications. By the time this Statement of Intent was filed, Atmos Pipeline – Texas had thousands of projects with hundreds of thousands of documents supporting the projects to be reviewed. Since the last rate

¹⁸ TEX. UTIL. CODE §104.301(d).

¹⁹ TEX. UTIL. CODE §104.301(h).

²⁰ TEX. UTIL. CODE §104.301(a).

²¹ 16 Tex. Admin. Code § 7.7101.

²² Atmos Ex. 6, Direct Testimony of Richard A. Erskine, p. 6, lns. 1 - 3.

²³ Added by Acts 2003, 78th Leg., Ch. 938, Sec. 1, Eff. Sept. 1, 2003. Amended by Acts 2005, 79th Leg., Ch. 948, Sec. 1, Eff. Sept. 1, 2005.

²⁴ Tex. Util. Code § 104.301.

²⁵ GUD No. 9400, Statement of Intent filed by TXU Gas Company to change rates in the Company's Statewide Gas Utility System, that Atmos Pipeline – Texas uses as the docket to adjust its rates and the source for the key components for the calculation, Return on Investment (ROR), depreciation Expense, Ad Valorem Taxes, Revenue Related Taxes, and Incremental Federal Income Taxes.

²⁶ 16 T.A.C. § 7.7101.

case, which used a test year ending December 31, 2002, almost \$482 million of additional capital investment has been made in the Atmos Pipeline – Texas system, including the capital investment through March 31, 2010.²⁷ Once the Commission approves the rates in this docket, the seven IRA filings and the capital investment associated with those will no longer be subject to refund. While review of the IRA filings represents a significant hurdle, it should be noted that the data required by the GRIP statute has not previously been available in traditional statement of intent cases. In other words, the regulatory authority and the Intervenor have at their disposal a level of detail not previously available prior to the statement of intent case.

Atmos Pipeline – Texas filed this *Statement of Intent* on September 17, 2010. The Examiners recognized the task of reviewing the IRA filings and confirming the justness and reasonableness of capital investment for seven years was enormous. RRC Staff identified 3,357 additions and 866 retirement GRIP projects in the seven IRA filings.²⁸ While it is true the utility has the burden of proof in a rate case, it is up to Intervenor to challenge the veracity of the various components of that filing. In this specific instance, the Intervenor must provide evidence that projects were unnecessary, imprudent, not applicable to Atmos Pipeline – Texas or any other issue to be addressed related to the IRA filings, not to mention the items normally contested in a statement of intent. In this docket, Intervenor had a huge burden in reviewing the seven IRA filings and that GRIP issues could distract from the customary review of a utility's rate increase application, such as rate of return, depreciation, allocations, rate design, etc. Early in this proceeding, the Examiners attempted to provide certain procedural parameters to guide the process in an expeditious manner that complied with the statutory requirements of IRA, allowed for a thorough review, conserved judicial resources, and preserved due process.

b. Procedural History and Adequacy of Proceedings

Early in this case, the Examiners' issued **Examiners' Letter No. 3** on September 23, 2010, to Atmos Pipeline – Texas which among other items addressed in the letter, requested APT identify amounts that were removed from IRA filings that were now included in this rate case.²⁹ The intent of **Examiners' Letter No. 3**, in part, was to help identify a potential issue of amounts that were at one time excluded for one reason or another from the IRA filings but were now included in rate base in this proceeding. Atmos Pipeline – Texas responded to the Examiners request on October 4, 2010. The response provided insight into expenses and projects removed from each IRA filing and what was included or excluded from this rate case.³⁰

To properly complete the cycle under the statute, each of the seven IRAs requires closure. That closure is in the form of an affirmation that the investment in capital included in the projects in each IRA filing was both prudent and necessary. To that end, the Examiners' issued **Examiners' Letter No. 4**,³¹ on September 24, 2010, to Staff. **Examiners' Letter No. 4** requested that Staff advise on three subjects. First, to identify amounts removed from each of

²⁷ Atmos Ex. 12, Direct Testimony of Jeffrey S. Knights, p. 22, lns. 9 – 11.

²⁸ Staff Ex. 1, p. 11.

²⁹ Examiner's Letter No. 3, Request for Information No. 1 – 9.

³⁰ APT timely filed its response on October 1, 2010 responding to Examiners' Letter No. 3.

³¹ Examiners' Letter No. 4 was directed to Staff which included three requests for information. The response from Staff was to be filed no later than October 12, 2010. On September 27, 2010, Staff filed a request for a protective order and to be able to file its responses to the Examiners' RFIs in their direct testimony, giving Staff ample time to file a meaningful response. Examiners' Letter No. 9 granted Staff's request.

the seven IRA filings and provide copies of documentation from each filing giving evidence of the adjustment. Second, to ascertain whether amounts removed from the seven IRAs have been included in the Cost of Service, or rate base, in this docket, GUD No. 10000. And third, for any amount that has been included in this docket to indicate whether those amounts are proper to include. Staff's responses to these questions are addressed below.

Examiners' Letter No. 9, issued on October 11, 2010, among other issues addressed, directed all parties to file a *Statement of Position* as to all issues related to IRAs previously filed by Atmos Pipeline – Texas. The Examiners instructed the parties to identify all interim rate adjustment issues in a *Statement of Position* that the parties are challenging that are not directly challenged by a testifying witness in their pre-filed direct testimony. The Examiners further advised that to the extent an issue is not directly challenged either in the prefiled testimony of the Intervenor or in the Statement of Position, it would be inferred that the Intervenor finds the unchallenged expenditures are just and reasonable.

Short of ordering the Intervenor to review the IRAs, the intent of Examiners' Letter Nos. 4 and 9 was to put the parties on notice of the requirements of IRA, that the statute requires review at this juncture, place the Commission on notice as to the issues to be presented by the parties, and provide the applicant adequate opportunity to prepare a review of the massive number of projects and support documentation.

ATM simply declined to review the IRA filings at this time. ATM characterized the data as "boxcar voluminous".³² ATM contended it is too much to review in the time allowed. ATM intended to conduct a prudence review but in light of the volume of data, brevity of time in a general rate case, a general rate case is not conducive to conduct a meaningful review and evaluation.³³ ATM states the cities have no standing to participate in the review of GRIP filings at the time the filings are made.³⁴ Contrary to the procedural requirements of the statute, ATM recommends a prudence review when IRA filings spans multiple years, which should commence 100-150 days prior to the company's general rate case. ATM made no specific disallowances but reserved the right to conduct cross-examination on all issues related to GRIP and propose disallowances supported by the evidence.

The State Agencies largely echoed the position of ATM and suggested that the procedural and regulatory requirements set forth by the legislature were inadequate. The State Agencies took the position that Atmos has the burden of proving every element of GRIP investments. Further, Atmos Pipeline – Texas must put on a *prima facie* case. State Agencies reserved the right to address additional issues which may be raised related to GRIP.

The City of Dallas addressed a few issues in its testimony and Statement of Position, and asserted that it would address other unidentified issues through cross examination as required. CoServ Gas Ltd. elected not to address any specific issue in their *Statement of Position* although reserved the right to respond to statements by other parties.

³² ATM's Statement of Position Regarding GRIP Investments, p.1.

³³ *Id*

³⁴ *Id*

The consensus among ATM, ACSC, City of Dallas and Staff in either their *Statement of Position* or in their direct testimony was that it was too much material to even begin a review. It appears from reading the direct testimony of the Intervenor, the Intervenor did not conduct much of a review of the projects, if any review. While the State Agencies are correct that Atmos Pipeline – Texas has the burden in this case, it is also true that the initial filing made by Atmos Pipeline – Texas provides ample evidence upon which to base a *prima facie* case. Unless an issue is raised, discussed, litigated, and evidence is introduced into the record to the contrary, all of the projects, amounts and calculations requested by Atmos Pipeline – Texas in their seven IRA filings will be deemed reasonable, necessary and prudent. By filing no pre-filed testimony and introducing no evidence in the case, the Examiners conclude that the State Agencies, CoServ and Industrial Gas Users have no objections to specific IRA investments.

The Examiners note that while the GRIP statute and the Commission Rule do not provide for intervention or a hearing, parties are not precluded from reviewing the filings at the Commission at the time the IRA filing is submitted. Additionally, the cities were not precluded in this proceeding from hiring consultants, assistants, or experts to concentrate on conducting a review specific to each IRA filing, as rate case expense reimbursement to the cities is provided. The Examiners find it troubling that all parties have known for five years of this impending proceeding yet claim surprise at the volume of information available when the proceeding commences.

On January 10, 2010, Atmos Pipeline – Texas filed an objection and request for limitation of cross-examination regarding ATM's, City of Dallas' and State Agencies *Statements of Position*.³⁵ APT's objection was that the Intervenor ignored Examiners' Letter No. 8 and did not provide in their Statement of Position specific issues. Atmos Pipeline – Texas noted that while the company made its files available for inspection to the parties, no representative from ATM, City of Dallas or State Agencies reviewed the files related to the investments made in those IRA proceedings.³⁶

The Examiners find this significant because ATM and City of Dallas, as well as ACSC, have the statutory right to request and receive rate case expense for, if need be, hiring an additional consultant or assistant to concentrate on nothing but the IRA filings of Atmos Pipeline – Texas.³⁷ The implied notion that an Intervenor has the right and ability to employ specialists as witnesses for rate of return, depreciation, rate design, etc. but could not employ an expert to review a sample of GRIP projects within the confines of the time frame of a statement of intent and within the limitations imposed by the legislature is without merit. Both the TEX. UTIL. CODE and the Commission rule contemplate for rate case reimbursement to the cities.³⁸ TEX. UTIL. CODE § 103.022 specifically provide that a municipality may engage rate consultants, accountants, auditors, attorneys, and engineers to conduct investigations, present evidence and advise and represent the governing body. Mr. Nalepa, who testified on behalf of ACSC, and Staff were the only parties to file testimony and it was on a limited review.

³⁵ Atmos Pipeline – Texas' objection and request for limitation of cross-examination regarding ATM's, Dallas', and State Agencies' Statement of Position on GRIP issues., filed January 10, 2011.

³⁶ *Id* at footnote 2.

³⁷ The recovery of rate case expenses is not available to Staff of the Railroad Commission, and entities that intervene that are not regulatory authorities.

³⁸ TEX. UTIL. CODE § 103.022 and 16 TEX. ADMIN. CODE § 7.5530 allow reasonable and substantiated rate case expense reimbursement to the utility and the cities.

Atmos Pipeline – Texas alleged in their objection that the Intervenor intended to ambush the company at the hearing.³⁹ Atmos Pipeline – Texas complained that if the Intervenor is permitted to essentially develop their case during the hearing, the company was denied due process. Atmos Pipeline – Texas who has the burden of proof, is entitled to develop and present evidence to rebut the challenges to specific expenses and investment. Atmos Pipeline – Texas went on to state it is effectively impossible for the company's witness to commit to memory every GRIP project. Even ATM in their *Statement of Position* conceded that there were thousands of GRIP projects that were made available for inspection.⁴⁰ Atmos Pipeline – Texas pointed out that these parties failed to identify a single GRIP project to be challenged but reserved the right to conduct cross-examination on or address additional issues related to GRIP.

The Examiners agreed with Atmos Pipeline – Texas that the hearing should not be a venue for a fishing expedition.⁴¹ And, no party appealed the ruling encompassed in **Examiners' Letter No. 8** and **Examiners' Letter No. 10**. The Examiners concluded that issues specifically addressed in requests for information, the response to those RFIs, and in the Intervenor's *Statement of Positions* or in direct testimony was open for cross-examination. The Examiners held further that as the parties refused to identify specific issues, the parties are unable to make a showing of good cause why cross-examination on issues not previously identified should be allowed at the hearing.

As is the case with any *Statement of Intent* proceeding, the utility has the burden of proof. The company's burden is no less in this docket than any other. One key difference in this docket and any other routine statement of intent or appeal is that this docket was required by statute. Thus, the filing of this case was not a surprise as it was mandated by statute. As already noted all IRA investments are subject to refund and must be reviewed at this juncture. This is a factor not at issue in a traditional *Statement of Intent* proceeding. Yet another key difference is the listing of capital investment by project. If a utility has not availed itself of GRIP and files a statement of intent, a listing of capital investment is *not* readily available. On the other hand, a utility that elects to avail itself of GRIP must meet certain filing requirements. The Commission rule requires a project report in every IRA filing, this is a level of detail not seen in other rate cases. The result is that a utility that chooses to use GRIP has already filed more detail for review than ever before and certainly more than a utility that does not use GRIP.

The statute and rule are clear, as well as the evidence presented by the parties in this case. Atmos Pipeline – Texas had the right under statute and rule to make IRA filings. Atmos Pipeline – Texas included projects in their IRA filings that represented infrastructure investment. Atmos Pipeline – Texas voluntarily removed at their own initiative or removed at the Commission's request capital investment or amounts from the IRA filings. The resulting adjustment to the rates from the more than 3,357 additions and 866 retirement capital investment projects⁴² included in those seven IRA filings is subject to refund until a final order

³⁹ *Id* at p. 2.

⁴⁰ ATM's Statement of Position filed December 17, 2010 at 3 and State Agencies' Statement of Position filed December 17, 2010 at 1.

⁴¹ Examiners' Letter No. 19, p. 2.

⁴² Staff Ex. 1, p. 11.

is issued in this docket. The only point in time to review these adjustments, the capital investment and to contemplate a refund is now, in this docket.

The Examiners conclude that the procedure made available to the parties in this case ensured an opportunity to perform a complete and adequate review of the investments made in each of the IRA filings. The Examiners find further that the applicant may include in this docket any and all infrastructure capital investment and related expenses that occurred regardless of what was voluntarily removed in any particular IRA filing. The fact that it was removed and not included in an IRA filing does not preclude it from being eligible for recovery in this docket. Of course, they will be subject to review in this proceeding and the utility must establish that they are reasonable and necessary.

7. Interim Rate Adjustment Issues (IRA) – Specific Items Addressed.

With regard to specific recommended GRIP adjustments, there are two categories of adjustments. First are adjustments to the seven IRA filings. Second, adjustments related to the cost of service. Some adjustments are only to the IRA filings because the impact is specific to that IRA filing as a stand-alone docket. Other adjustments are to the cost of service in this docket because they are derived from the IRA filings but the impact is in this cost of service.

ACSC's witness Karl J. Nalepa identified three broad areas of adjustments:

- Recalculations for violating the restrictions of the GRIP statutory provisions regarding changing methodologies for certain plant investments and calculating taxes;
- Removal of unreasonable plant investments; and
- Reductions for over-recovering return on investment.⁴³

Two sub-issues were raised related to the company's alleged failure to follow the GRIP statute: a) inclusion of Shared Services, and b) a change in methodologies with the calculation of *Ad Valorem* Tax. ACSC contends that the Shared Services plant allocated to Atmos Pipeline – Texas should not be allowed in the IRA filings because GUD No. 9400 did not provide for any Shared Services plant in the company's rates.⁴⁴ Mr. Nalepa is not opposed to the allocation of Shared Services in this docket, provided the Commission finds them reasonable.⁴⁵ ACSC documented that Atmos Energy Corporation began allocating Shared Services to Atmos Pipeline – Texas in the 2005 IRA filing. Mr. Nalepa contends that Atmos should not have made any allocations from Shared Services investment because GUD No. 9400 did not address nor did it provide for any Shared Service adjustments.⁴⁶ ACSC has identified \$18,354,682 of allocated shared service plant that should not have been allocated from the 2005 through 2009 IRA filings.⁴⁷ ACSC's recommended adjustment is to the IRA Filings only.

⁴³ ACSC Ex. 3, Direct Testimony of Karl J. Nalepa, p. 32, lns.7-13.

⁴⁴ *Id* at p. 33, lns. 15-17.

⁴⁵ *Id* at p. 34, lns. 1 – 2.

⁴⁶ GUD No. 9400 was a Statement of Intent filed by TXU Gas Company on May 23, 2003 for a test year ended December 31, 2002. That statement of intent was for both the Distribution assets and the pipeline assets which were considered in the same docket. A Final Order was signed by the Commission on May 25, 2004. When GUD No. 9400 was filed, they were limited to the shared services provided.

⁴⁷ ACSC Ex. 3, Direct Testimony of Karl J. Nalepa, p. 35-37, Table 3.

Mr. Nalepa also objected about the change in methodology employed by the company in calculating the *Ad Valorem* Tax expense. Staff also identified this as an issue. This change occurred in the 2006 IRA filing. According to Mr. Nalepa, Atmos Pipeline – Texas should have used the methodology approved in GUD No. 9400. RRC Staff asserts that since estimates were used in the change of methodology and not corrected to actual, then an adjustment through a refund is warranted. Atmos Pipeline – Texas claimed the tax law changed which resulted in the change in the methodology. Mr. Nalepa also contends any adjustment as a result of using estimated property tax factors should be refunded in this proceeding and not in the next IRA filing. Staff agrees. Additionally, Mr. Nalepa offers that the *Ad Valorem* Tax is an expense and should not be increased and recovered in any IRA filing.⁴⁸

The following table, Table 7.1 shows the *Ad Valorem* Tax adjustment recommended by ACSC witness Nalepa and Staff witness Ruiz.⁴⁹ ACSC and Staff recommend the total of \$1,097,601.14 from the table below be refunded with interest in this docket.

Table 7.1

	2007 Tax Year	2008 Tax Year	2009 Tax Year
Ad Valorem Tax Total	\$5,794,149.79	\$5,811,938.36	\$7,123,168.71
Estimate	\$6,200,000.00	\$6,129,674.00	\$7,497,184.00
Difference	(\$405,850.21)	(\$317,735.64)	(\$374,015.29)
	Total		\$1,097,601.14

According to Staff, the Commission's policy was that "Ad Valorem taxes are not specifically designated as a factor that must remain the same." GUD No. 9400 set the property tax factor of 1.305%.⁵⁰ Staff reconciled the estimates used to the actual expense and has calculated an over collection of \$1,097,600 in *Ad Valorem* Taxes. Staff states that the company agrees with Staff on the amount to be refunded but proposes to apply the refund to the 2010 IRA Filing. Staff is of the opinion that the GRIP Statute requires refunds to be applied in this Statement of Intent. While this adjustment is related to five of the seven IRA filings, the recommendation by ACSC and Staff is that the adjustment should be made in this filing. Using allocation factors from GUD No. 9560 (the first IRA filing) and current meter counts from this docket, GUD No. 10000, Staff recommends a one-time per meter refund of \$1,198 for CGS customers and \$3,758 for PT customers.⁵¹

The Examiners agree and recommend the refund of \$1,097,601.14, plus interest, as proposed by Staff be made in GUD No. 10000. The Examiners do not find sufficient evidence in the record to make a recommendation on ACSC's contention that *Ad Valorem* Tax is an expense and should not be included in IRA filings. The GRIP Statute specifically allows for *Ad Valorem* Tax to be included in the calculation of the interim adjustment.⁵² The Examiners, therefore, recommend denying ACSC's recommendation that *Ad Valorem* Tax be excluded from the IRA calculation.

⁴⁸ ACSC Ex. 3, Direct Testimony of Karl J. Nalepa, p. 35, Ins. 4-9.

⁴⁹ Table 7.1 is taken from the testimony of the Staff.

⁵⁰ Staff Ex. 1, p. 9.

⁵¹ Staff's Initial Brief, p. 2.

⁵² Tex. Util. Code § 104.301(d).

The second issue raised by Mr. Nalepa is that Atmos Pipeline – Texas has inappropriately included in both the IRA filings and in this docket, unnecessary investment and expenses. ACSC identified investments in the 2005, 2006, 2007, 2008 and 2009 filings that should have been removed. In the 2005 filing, Atmos Pipeline – Texas should not have included transfers of assets from one division to another. Computers and software purchased from CapGemini should not have been included because an agreement gave the option of purchasing or leasing. ACSC contends that Atmos Pipeline – Texas should have leased and not purchased them. Additionally, ACSC identified 70 computers that were purchased for 60 employees. And, based on the utility's computer 4-year replacement policy, only 25% of the 60 computers, or 15 computers, should be allowed.⁵³ Improvements to the Lincoln Center and the Greenville offices should be disallowed because they were shared service projects. ACSC offers that the cost to "re-brand" by purchasing signs offers no benefit to Atmos Pipeline – Texas customers and should be excluded.

In the 2006 and 2007 IRA filings, ACSC asserts adjustments are necessary related to the Greenville Office improvement, as identified above. In the 2008 IRA filing, ACSC seeks an adjustment for Shared Service Additions, computer purchases and a television set for the transportation marketing group. In the 2009 IRA filing, ACSC again identified Shared Service projects to be removed and excess computers purchased.

ACSC Nalepa recommends removal of \$80,350⁵⁴ of direct plant related to computer purchases. Witness Nalepa reasons that Atmos Pipeline – Texas has 60 employees yet the company has purchased and put into service 159 computers (laptops and PCs).⁵⁵ Mr. Nalepa also recommends removal of \$22,213⁵⁶ of Shared Services plant (net to Atmos Pipeline – Texas) because these costs are related to the customer call center or the Atmos Mid – Tex gas supply group.⁵⁷ The total plant Mr. Nalepa recommends be removed is \$102,563. Finally, ACSC recommends removal of \$722,213 of plant and associated depreciation of \$50,721 related to capitalized travel, meals and entertainment, transportation and lodging that had been removed for the IRA filings.⁵⁸ ACSC reasons that since they were removed from the IRA filings, they should be removed from this docket.

Atmos Pipeline – Texas filed rebuttal testimony⁵⁹ explaining the build-out of the Lincoln Center was necessary for the company to office in the building. The Greenville Avenue facility investment was necessary for the relocation of the SCADA Group from downtown Dallas when the Atmos Energy Corporation merger took place. In addition, Atmos Pipeline – Texas asserts that two of the five projects Mr. Nalepa includes in his recommended adjustments were not included in this filing. The third project is not a call center project but an upgrade to the Franchise Fee Computer System. The fourth project Mr. Nalepa includes is a project related to

⁵³ ACSC Initial Brief, p. 12.

⁵⁴ ACSC Ex. 3, Direct Testimony of Karl J. Nalepa, Schedule KJN-2.

⁵⁵ ACSC Ex. 3, Direct Testimony of Karl J. Nalepa, p. 8, lns.5-9.

⁵⁶ ACSC Ex. 3, Direct Testimony of Karl J. Nalepa, Schedule KJN-2. The gross plant before allocation is \$172,321, after allocation from Shared Services to APT it is \$22,213.

⁵⁷ *Id* at lns. 10-12.

⁵⁸ *Id* at lns. 13-18.

⁵⁹ Atmos Ex. 22, Rebuttal Testimony of Jeffry S. Knights, p. 10 – 14.

the complex billing system the utility utilizes. The final project is a \$217 rate-base item that Atmos Pipeline – Texas says they will not oppose an adjustment for administrative efficiency.

While ATM did not file testimony or provide evidence at the hearing regarding the IRA filings, ATM supports ACSC's reduction of \$722,213 ATM characterized as "multiple unreasonable plant investments" which ATM goes on to characterize as excessive computers and software purchases.⁶⁰ ATM agrees with ACSC that Atmos Pipeline – Texas deviated from the Final Order in GUD No. 9400 in their GRIP filings by allocating Shared Services.

The Examiners note that ATM's reference to \$722,213 relating to computer and software purchases is not correct. The \$722,213 is ACSC's adjustment for travel, meals, entertainment, transportation and lodging.⁶¹ And, to be completely accurate, ACSC's recommendation must include the associated depreciation of \$50,721 with the capitalized \$722,213 of travel and meals. Although ATM opposes capitalization of meals and lodging, the capitalizing of meals, lodging, travel, and transportation it is specifically permitted by the FERC USOA⁶² and supported by the Commission in previous rate cases.⁶³ Finally, while ATM supports the exclusion of certain meals and caps for meals, no dollar amount was provided for the Examiners to exclude.⁶⁴

Atmos Pipeline – Texas, in a recap, states that between January 1, 2003, the company has invested \$482 approximately million to install over 76 miles of pipe, including 3 major system fortification projects and over 22,800 horsepower of compression.⁶⁵ The applicant asserts that the Intervenor urge disallowances related to GRIP projects when they admittedly failed to review or even request to review a single IRA file in the case.⁶⁶

Atmos Pipeline – Texas contends that capital investments are made to the system to replace pipeline facilities that have reached their useful life, relocate pipeline facilities for public and private economic development, add pipeline facilities for growth or for shifts in supply and demand, and to comply with state and federal regulations. Atmos Pipeline – Texas goes on to state that capital projects are also necessary for general plant such as tools, equipment, buildings, and software.⁶⁷ With limited exceptions, the reasonableness and prudence of the investment has not been challenged.⁶⁸

Atmos Pipeline – Texas states that the only party to review the company's GRIP projects in this case was Staff. The company noted that ACSC was the only party to propose a

⁶⁰ ATM Reply Brief, p.5.

⁶¹ ACSC Ex. 3, Sch. KJN-3.

⁶² FERC USOA Gen. Inst. No. 3 & 4.

⁶³ Final Order GUD No. 9670, FOF 109; Final Order GUD No. 9762, FOFs 31-35. Capitalized and non-capitalized expense for travel and meals was not litigated in GUD No. 9869.

⁶⁴ Examiners' Letter No. 9, issued on October 11, 2010, among other issues addressed, directed all parties to file a *Statement of Position* as to all issues related to IRAs previously filed by APT. The Examiners instructed the parties to identify all interim rate adjustment issues in a *Statement of Position* that the parties are challenging that are not directly challenged by a testifying witness in their pre-filed direct testimony.

⁶⁵ Atmos Initial Brief, p. 2.

⁶⁶ *Id.*

⁶⁷ *Id.* at p. 3.

⁶⁸ *Id.* at p. 4.

specific adjustment to the company's requested level of capital investment.⁶⁹ ACSC proposed to disallow investment in computers, as well as other electronic equipment, signage, investment in the Lincoln Center and Greenville Avenue facilities, and certain additional investment made by Shared Services.⁷⁰ The applicant notes that ACSC Mr. Nalepa does not challenge the used and usefulness of these investments.⁷¹

However, Atmos Pipeline – Texas concludes that Mr. Nalepa misunderstands the terms of the agreement of the transition from TXU to Atmos Energy Corporation regarding the CapGemini computer issue. The agreement required Atmos Energy Corporation to either purchase the used equipment or purchase new computers. Facing the potential of lost data by purchasing new computers and software, Atmos Pipeline – Texas decided purchasing the used equipment was the most cost effective and administratively efficient option.⁷²

Atmos Pipeline – Texas responds that Mr. Knights' rebuttal testimony⁷³ demonstrates that: 1) the electronic equipment is necessary for monitoring up-to-the-minute weather and forecasts that might change operational requirements and demands on the system; 2) Mr. Nalepa's signage adjustment includes not only the building and station signage but all investment related to signage including signage on vehicles and pipeline facilities; 3) the Lincoln and Greenville projects relate to necessary build-out of the company's floor space; and 4) two of the five shared service projects identified by Mr. Nalepa are used and useful to provision of service, were reasonably and necessarily incurred, while two others have already been removed from this filing.⁷⁴ Atmos Pipeline – Texas points out that the Commission has already approved the allocation of shared services in two Atmos Mid-Tex dockets, GUD Nos. 9762 and 9869.⁷⁵

Atmos Pipeline – Texas takes exception to the fact that, to reduce controversy in the IRA filings, certain eligible investments were removed from those IRA filings. They have been included in this proceeding but are being challenged by mere virtue of the fact that they were voluntarily removed in the IRA proceedings. The applicant made it clear in each filing that they would seek to recover this investment in the Statement of Intent Proceeding. The utility states that Mr. Nalepa argues that investment voluntarily removed from each IRA filing should be ineligible for recovery in this case.⁷⁶ Atmos Pipeline – Texas claims that Mr. Nalepa offers no support for his position and the company points out that Mr. Nalepa does not challenge the reasonableness of the investment. Atmos Pipeline – Texas claims that the evidence demonstrates that each and every capital investment is used and useful.⁷⁷ As a result, the applicant should be able to recover all of its used and useful capital investments.

The Examiners find that the company's analysis of its voluntary removal in the IRA filing of certain items is correct. The mere removal does not preclude the company of the

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Id.* at p. 5.

⁷² *Id.* at p. 5.

⁷³ Rebuttal Testimony of Jeffrey S. Knights, APT Ex. 22.

⁷⁴ Atmos Initial Brief, p. 5.

⁷⁵ *Id.*

⁷⁶ *Id.*

⁷⁷ *Id.* at, p. 7.

ability to seek recovery in the subsequent Statement of Intent filing. The Examiners find ACSC's recommendations on this point to be without merit. The Examiners find that the voluntary removal of amounts or projects from an IRA filing does not preclude the utility from including those amounts for consideration in this docket. Furthermore, the ACSC did not provide sufficient evidence that suggests: 1) purchasing more computers than the Company policy provided was a waste or unnecessary, and 2) it has not been established that the allocation of shared services is in error. Quite the contrary, the Commission has approved the allocation of shared services in IRA filings for the company's distribution division in GUD Nos. 9670, 9762 and 9869. ACSC's recommendation of removing meals is addressed in a later discussion in this section. With regard to the projects ACSC recommends be removed, the Examiners find that the utility has provided sufficient evidence supporting the inclusion of the projects in this docket as they appear to be directly associated with the provision of natural gas service.

The third argument Mr. Nalepa makes is that Atmos Pipeline – Texas over-earned on the investment because Atmos Pipeline – Texas exceeded the overall Rate of Return (ROR) set in GUD No. 9400 in Calendar Years 2005, 2008, and 2009.⁷⁸ Mr. Nalepa acknowledges that the interim rate adjustment can be approved even if the Earning Monitoring Report (EMR) shows an over-earning but claims the rates must be adjusted in the final review because a utility cannot exceed its allowed ROR.⁷⁹ GUD No. 9400 established an ROR of 8.258%. Mr. Nalepa uses as his basis for analysis and conclusion TEX. UTIL. CODE §§ 104.301(g), 104.003, 104.004 and 104.005.⁸⁰ The following table, Table 7.2, is found in Mr. Nalepa's testimony.⁸¹ The table shows the company's imputed ROR (actual) and the difference between that and the 8.258% set in GUD No. 9400. ATM also supports ACSC's contention that Atmos Pipeline – Texas over-earned on its rate of return.

Table 7.2

	2003	2004	2005	2006	2007	2008	2009
Actual ROR	6.884%	7.466%	8.542%	7.234%	8.180%	8.409%	8.639%
ROR Difference	(1.374%)	(0.792%)	0.284%	(1.024%)	(0.078%)	0.151%	0.381%

The Examiners note that TEX. UTIL. CODE § 104.301(g) does not disallow the interim adjustment if the calculated ROR in the IRA filing is over the ROR set in the base docket, in this instance GUD No. 9400. The statute provides that if the utility is earning a return on invested capital of more than 75 basis points, it shall file a statement stating the reasons why the rates are not unreasonable or in violation of the law. The Examiners find that this does not

⁷⁸ ACSC Ex. 3, Direct Testimony of Karl J. Nalepa, p. 40, Ins. 10 - 18.

⁷⁹ ACSC Ex. 3, Direct Testimony of Karl J. Nalepa, p. 41, Ins. 2 - 6.

⁸⁰ 104.301(g) states, "If the gas utility is earning a return on invested capital, as demonstrated by the report filed under Subsection (f), of more than 75 basis points above the return established in the latest effective rates approved by a regulatory authority for the area in which the tariff or rate schedule is implemented under this section, the gas utility shall file a statement with that report stating the reasons why the rates are not unreasonable or in violation of law." 104.003, 104.004 and 104.005 deals with just and reasonable rates, unreasonable preference and prejudice being prohibited and equity of rates and services, respectively.

⁸¹ ACSC Ex. 3, Direct Testimony of Karl J. Nalepa, p. 40, Table 4.

imply the utility may not implement the rate. In a decision handed down by Judge Triana,⁸² the court determined that regulatory agencies do not have the authority under the statute to reject an IRA filing or make modifications to one. The IRA must be approved. The recourse for the regulatory agencies is to initiate an inquiry.

The Examiners find that the years Mr. Nalepa refers to do not exceed 75 basis points so, as a result, no statement was required by the utility and the utility was working within the statute's requirements. The Examiners also find the statutes Mr. Nalepa reference in the context of his analysis as misleading. His statement is, "[w]hile the GRIP provisions of GURA [Gas Utility Regulatory Act] allow the interim rate to be approved even if the EMR [Earnings Monitoring Report] shows that the company was over-earning, [reference to 104.301] the rates must be adjusted in the final review because a utility is not allowed to earn more than its allowed ROR. [references to 104.003, 104.004, 104.005]" TEX. UTIL. CODE § 104.301(g) does not address adjusting the rates if a company is over-earning and TEX. UTIL. CODE § 104.003, 104.004 and 104.005 makes no citation to adjustment of a utility's rates earning more than its "allowed ROR".

The Examiners do not find sufficient evidence proving Atmos Pipeline – Texas violated any statute or Commission rule by earning more than the overall ROR set in GUD No. 9400. Neither the statute nor the rule disallows earning more than was set in the base docket an IRA uses for its determination. A utility is provided a reasonable opportunity to earn a reasonable return. The concept that a utility may not earn more than the ROR set in a rate case implies the utility may not earn less either. As the Table 7.2 shows, in four of the seven GRIP years, Atmos Pipeline – Texas earned less than 8.258%. The Examiners recommend rejection of ACSC's recommendation that a refund is necessary for earning more than the 8.258% ROR set in GUD No. 9400.

The Examiners issued **Examiners Letter No. 4** with a series of RFIs to Staff. Staff's requested an extension to respond to the Examiner's RFIs⁸³ and to be allowed to address the issues in testimony.⁸⁴ Staff witness Rose A. Ruiz filed direct testimony on December 22, 2010.⁸⁵ Staff's testimony covered three primary areas: 1) Staff's response to **Examiners' Letter No. 4**; 2) Disallowance due to reconciliation of estimated property tax to actual; and, 3) A GRIP review recommendation.

Examiner's RFI 1-1 directed Staff to identify the amounts removed and to provide copies of documentation from the filing that evidence the adjustment. Staff's response to RFI 1-1 was that items fell into basic categories of ancillary workplace improvements and equipment from pipeline and shared service additions, exclusions of specific projects, employee expense account costs from pipeline and shared services additions, expense account costs from business unit overheads from pipeline additions and shared services and adjustments for shared service additions, relocation adjustments and accumulated depreciation.⁸⁶ Staff provided the following table, Table 7.3, for adjustments.

⁸² ACSC Ex. No. 74. Cause No. D-1-GV-05-5221, Final Judgment, Honorable Gesela D. Triana, Judge Presiding.

⁸³ Examiners' Letter No. 4, dated September 24, 2010.

⁸⁴ Staff's Motion for Protective Order, filed September 27, 2010.

⁸⁵ Staff Ex. 1.

⁸⁶ Staff Ex. 1, p. 4.

Table 7.3

IRA Year	2003 (1)	2004 (2)	2005 (3)	2006 (4)	2007 (5)	2008 (6)	2009 (7)
GUD No.	9560	9615	9664	9726	9788	9855	9950
Adjustments As Filed	0	0	2,694,599	1,654,12	2,817,421	3,789,131	11,027,314
Additional Adjustments per RRC	0	0	662,725	0	0	0	982,500
IRA Amount Requested	1,801,725	1,918,699	3,381,769	13,025,772	6,969,743*	7,549,500*	14,879,480*
IRA Amount Approved	1,801,725	1,91,699	3,286,353	13,201,664*	6,969,743*	7,549,500*	14,730,957*
Net Adjustment	0	0	2,031,874	1,654,120	2,817,421	3,789,131	10,044,814

* Alternative Property Tax Calculation Method Approved

Examiner's RFI 1-2 directed Staff to ascertain whether the amounts removed from each IRA docket have been included in the cost of service (rate base) in this docket, GUD No. 10000. Staff's response to RFI 1-2 referenced the company's response to the Examiners' similar RFI to Atmos Pipeline – Texas, RFI Set No. 1, RFI 1-09, which the Examiners accept as Staff's confirmation of the company's accuracy in Atmos Pipeline – Texas's response to the Examiner's RFI. And, that Atmos Pipeline – Texas has included all other amounts direct to Atmos Pipeline – Texas and amounts allocated from Atmos Energy Corporation for shared service, which were at one time removed from the seven IRA filings, but are now included in rate base in GUD No. 10000.⁸⁷

Staff identified 13 projects representing \$1,238,903.96 that had been removed from various IRA filings. Of that amount removed, the company included in GUD No. 10000 (\$259,897.00) representing three projects (presumably the negative amount represents an adjustment to the projects). Staff further identified an additional \$662,725.06 that had been removed from the 2005 IRA filing representing ancillary projects.⁸⁸ Staff has stated that Atmos Pipeline – Texas agreed to remove artwork at the beginning of the hearing in this case from the 2005 IRA filing totaling \$46,552.⁸⁹ Staff identified employee expenses that were removed as well. They are set forth on Table 7.4:

⁸⁷ Staff Ex. 1, p. 5.

⁸⁸ Ancillary projects are chairs, artwork and decorations, miscellaneous equipment, a specific project and signage.

⁸⁹ Staff's initial Brief, p. 3.

Table 7.4

	Shared Services – General Office	Mid-Tex*	Pipeline
TXU Projects 2003-2009	-	-	134,397**
TXU Overhead Project 1998-2005	-	-	512,767**
Calendar Year 2005	11,929	2,210	36,999
Calendar Year 2006	2,727	6,023	81,641
Calendar Year 2007	3,657	2,983	62,339
Calendar Year 2008	4,581	14,926	5,568
January 1 ,2009 through March 31, 2009	1,252	2,973	1

* Mid-Tex amounts were not previously removed from GRIP filings. This docket is the first time Atmos Pipeline – Texas removed these allocated amounts.

** TXU amounts were not previously removed from GRIP filings. This docket is the first time Atmos Pipeline – Texas removed these allocated amounts.

Examiners' RFI 1-3 directed Staff to indicate whether the amounts included (that were previously identified in RFI 1-2) are properly includable. Staff is of the opinion that Atmos Pipeline – Texas can propose inclusion of amounts in this docket subject to the same standard of review applied to invested capital in any rate preceding.⁹⁰ Staff identified a specific project, Project No. 010.11279, as being a project for the conversion of the Mississippi Billing System and believes this project amount of \$7,174 should be disallowed as it only benefits the Mississippi Division Customers. ATM recommends removal of Project No. 010.11279 as well, the Mississippi Billing System project identified by Staff. For ancillary amounts removed from IRA filings and included in this docket, Staff recommends the Commission limit these expenditures using the same criteria as that used by the Commission in GUD No. 9670. That being the Commission determined \$219 for a chair was reasonable.⁹¹ The Commission also determined that artwork is not necessary to provide gas service.⁹²

However, Staff did not identify specific amounts for removal attributed to furniture. Additionally, in Docket No. 9670, the Commission disallowed all capitalized expenses related to meals, travel, lodging, liquor and travel for spouses. ATM supports RRC Staff's recommendation of limiting meals to \$25 per-person, per-meal and the disallowance of any meal under \$25 not accompanied by a receipt.⁹³ Regarding meals and lodging, ATM states "[Atmos Pipeline – Texas] refers to these items as 'capital Expenditures' in its initial brief, rather than expenses, and discusses this issue as a rate base item. ATM opposes any capitalization of expenditures on hotels and meals, as these items are clearly *expenses*."

Atmos Pipeline – Texas removed from this docket, meals over \$50 per-person, hotels over \$250 per-night, alcohol, spousal travel, spousal expenses, spousal lodging, Board of Directors off-site committee expenses, certain dues, entertainment and gifts. Staff is of the opinion that the Atmos Pipeline – Texas audit criteria meets the standards set in GUD No. 9670,

⁹⁰ Staff Ex. 1, p. 7.

⁹¹ GUD No. 9670, FOF No. 88 and 89.

⁹² GUD No. 9670, FOF No. 91.

⁹³ ATM Reply Brief, at p. 6.

except that a per-meal and per-night hotel limit was not set. Staff is of the opinion that \$25 per-meal and \$150 per-night is reasonable for meals and lodging.

Staff contends that Atmos Pipeline – Texas has not met its burden of proof on lodging and meal expenses. The utility removed meals over \$50 and lodging above \$250 per night. According to Staff, the company looked at a mid-point between Texas and the East Coast. Staff represents that Atmos Pipeline – Texas did not take into account the percentage of employees traveling in Texas versus East Coast travel. Without a meaningful analysis of how much travel is within Texas as opposed to how much travel is done to the East Coast, a calculation of mid-point is meaningless, as East Coast travel is much more expensive than traveling in Texas. Further, Atmos Pipeline – Texas did not establish that more travel is in Texas or in the East Coast and that \$50 and \$250 was an appropriate level of expense for meals and lodging.⁹⁴

Staff demonstrated that \$50 per-meal or \$150 per day (assuming three meals per day at \$50 per meal) could not be supported when looking at the General Services Administration (GSA) per *diem* amounts for meals in Texas, New York and the District of Columbia.⁹⁵ When confronted on cross-examination, Barbara Myers, who testified on behalf of Atmos Pipeline – Texas, stated that she knew of no reason why state and federal workers could not adequately perform their duties given the maximum amounts set forth in the GSA per *diem* schedules.⁹⁶ Staff further identified another issue with meals, Atmos Pipeline – Texas does not require a receipt of a meal expense if it is under \$25. Without a receipt, there is no way of determining whether a meal was actually purchased or merely claimed in the report. Staff recommends disallowing any meal that did not accompany a receipt and all meal expense over \$25 and lodging expense over \$150.

With regard to meals and hotel expenses, the company claims that in the last two Atmos Mid – Tex rate cases, GUD Nos. 9762 and 9869, Atmos Mid – Tex, the Atmos Energy Corporation involved in those cases, voluntarily imposed its own limit on capital expenditures relating to meals and hotel.⁹⁷ Atmos Pipeline – Texas also notes that these limits were used in the Atmos Mid-Tex Rate Revenue Mechanism (RRM) filings.⁹⁸ Atmos Pipeline – Texas maintains that Staff is attempting to retroactively impose new mandatory limits with no specific adjustment. Atmos Pipeline – Texas believes its corporate policy of providing controls and limitations on employee expenditures is reasonable and the evidence in this case shows that the company was consistent with its practice in GUD Nos. 9762 and 9869.

The Examiners agree with Staff and recommend the Commission order Atmos Pipeline – Texas to exclude from future filings any meal expense over \$25 and lodging expense over \$150 that does not accompany a detailed receipt. The Examiners also agreed with Staff on the limitation of meals and lodging limited to \$25 per meal and \$150 per night lodging and requested Atmos Pipeline – Texas provide the analysis for removal of amounts over \$25 per meal and \$150 per night lodging expense.⁹⁹ Upon filing the analysis by Atmos Pipeline –

⁹⁴ Staff's Initial Brief, p. 2.

⁹⁵ *Id.*

⁹⁶ *Id.* at p. 3.

⁹⁷ Atmos Pipeline Initial Brief, p. 7.

⁹⁸ The RRM is a revenue adjustment mechanism that 400 plus cities agreed to as a result of a settlement during the 9762 Atmos Mid-Tex rate case. The only city that did not agree to a settlement was the City of Dallas.

⁹⁹ February 14, 2011 Atmos filing to Examiners Request.

Texas, the Examiners recommend an additional \$51,687 be removed from the cost of service in this docket that eliminates meals over \$25 and motel expense over \$150 per night.

The City of Dallas also argued that the Commission should order that the company submit a recalculation of annual GRIP amounts, to recognize changes in the accumulated deferred income tax calculations that occurred in the corresponding time-frame and that it alleged should have been reflected in each of the GRIP filings.¹⁰⁰ Mr. Pous noted that this issue is currently before the Texas Courts.

Staff witness Ms. Ruiz also makes the following recommendation. Ms. Ruiz has taken the position that the intent of the legislature in the GRIP statute was for a prudence review to be conducted of the IRA projects in the next rate case, which is this rate case for Atmos Pipeline – Texas.¹⁰¹ Ms. Ruiz suggests the Commission consider establishing requirements in this docket, GUD No. 10000, to lay a foundation for an evidentiary record in the next statement of intent. Staff recommends the Commission order that Atmos Pipeline – Texas hire a third party auditor to conduct the prudence review, have the auditor complete the review prior to the filing of the next statement of intent, to include the third party auditor's report, and all supporting data when the statement of intent is filed.

The City of Dallas' Reply Brief repeats and echoes the complaint of several Intervenors that with a "boxcar full of documents from all GRIP projects a meaningful review of statistical samples is just not possible for Intervenors."¹⁰² While the City of Dallas appreciates RRC Staff's recommendation for an auditor, it is the City of Dallas' opinion that it be selected by the Commission with input by the stakeholders in the process.

ATM's witness Mr. Carver determined "significant time and resources would be required far beyond what is available in a general rate case."¹⁰³ ATM maintains they were unable to conduct the desired prudence review of capital projects included in the company's GRIP filings.¹⁰⁴ ATM cites to the testimony of Staff witness Ms. Ruiz that a general rate case simply does not provide the requisite time to conduct a proper prudence review.¹⁰⁵ ATM notes that the company's witness Mr. Knights testified that documents related to the 2900 Atmos Pipeline – Texas and SSU Capital projects filled 260 file boxes and were treated by Atmos Pipeline – Texas as "boxcar voluminous."¹⁰⁶

ATM further states that Intervenors are not allowed to participate in GRIP filings outside of a general revenue case.¹⁰⁷ ATM does not oppose Staff's recommendation to require a third-party audit of GRIP, however, ATM urges for reviews of GRIP filings in general rate cases to be allowed to commence 100 to 150 days prior to the filing of the statement of intent to allow for a review.¹⁰⁸

¹⁰⁰ Dallas Ex. 2, p. 25, Ins. 10 – 27.

¹⁰¹ Staff Ex. 1, p. 11.

¹⁰² City of Dallas Reply Brief, p. 25.

¹⁰³ ATM Initial Brief, p. 39.

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*

The Examiners find Staffs' recommendation troublesome. The statute and Commission rule require the review of IRA filings be conducted in a general rate case. While the utility has the burden to prove all investment are just, reasonable and necessary, Staff's recommendation shifts the burden for review from regulatory authorities to the utility. In other words, in subsection (a), the statute speaks to the "subsequent review for reasonableness." It makes little sense that the review is conducted by the utility implementing GRIP. It also adds additional cost for this audit on the backs of the utility and rate payer. The Commission would need to develop policy setting out criteria for the auditor to use for the review. The Examiners do not recommend adoption of Staff's proposal and, as noted above, find that these proceedings provided ample opportunity to conduct a review of the amounts previously included in the company's IRA filings.

CoServ Gas, Ltd and Industrial Gas Users did not file pre-filed testimony and offered no comments regarding specific GRIP investments or the company's IRA filings. State Agencies, filed an initial brief on the subject of GRIP. State Agencies commented that since Atmos Pipeline – Texas made the decision to use the GRIP statute, the utility was required to file this Statement of Intent¹⁰⁹ and that despite earning in excess of the rate of return established in GUD No. 9400, the applicant asserts a \$35.3 million revenue deficiency. The implication of the State Agencies is that Atmos Pipeline – Texas should not be seeking a rate increase since their earnings were supplemented by GRIP. State Agencies provided no evidence to support this conjecture. While not directly related to GRIP, State Agencies hold that the company bears the burden of proof to justify its rates. And, while that is true, the proposed rates would need to be challenged with evidence supporting that the proposed rates are not justified. The Examiners are unable to make any recommendation regarding the State Agencies' allegations.

City of Dallas filed this in its initial brief regarding GRIP:

"Dallas did not address the specific projects in the GRIP filings, but it is obvious that these projects were, in part related to the intentions of this company to increase its 'Other Revenues.' Moreover, the GRIP filings do not reflect any changes in ADIT or ADIT offsets to rate base that occurred as a result of the \$482 million of plant that was added during the period of these projects."¹¹⁰

There is insufficient evidence in this record to support the allegations made by the City of Dallas regarding the company's motives and as noted above there is no evidence to support its contention that ADIT was calculated in error. Again, the Examiners are unable to make any recommendation regarding the City of Dallas' allegations and find that the ADIT calculations provided by the utility are just and reasonable.

¹⁰⁹ State Agencies Initial Brief, p. 2.

¹¹⁰ City of Dallas Initial Brief, p. 25.

8. Rate Base

For purposes of evaluating rate base, the test-year period for this case is the twelve months ended March 31, 2010.¹¹¹ Issues were raised by the Intervenors regarding utility plant in service, prepayments, accumulated deferred income taxes, storage gas, and cash working capital.

a. Utility Plant in Service

(A) Capitalized Expenses for Travel, Meals and Entertainment Previously Removed in Interim Rate Adjustment Filings Included in Rate Base.

These issues were raised as part of the IRA adjustment issues by ACSC through the testimony of Karl J. Nalepa. This issue is addressed in section 7 and the Examiners recommend no adjustment.

(B) Computer Equipment

These issues were raised as part of the IRA adjustment issues by ACSC through the testimony of Karl J. Nalepa. This issue is addressed in section 7 and the Examiners recommend no adjustment.

(C) Customer Call Center/Mid – Tex Gas Supply Group

These issues were raised as part of the IRA adjustment issues by ACSC through the testimony of Karl J. Nalepa. This issue is addressed in section 7 and the Examiners recommend no adjustment.

(D) Functionalization of Assets

ACSC's witness Nalepa argued that moving assets from Atmos Pipeline-Texas to Atmos Mid – Tex did not benefit either rate class customers of Atmos Pipeline – Texas. Mr. Nalepa argues the functionalization of assets between the two divisions benefits the company and not the customers.¹¹² Mr. Nalepa does not challenge the amount, just the transfer of assets. The project Mr. Nalepa proposes to be removed is a plant modification in 2005, a modification to install a new meter and regulator station costing \$123,298.¹¹³ The company responds that the customer benefits when the facility is properly functionalized and determined to be a distribution facility rather than a transmission facility.¹¹⁴

¹¹¹ Atmos Ex. 7, Direct Testimony of Barbara Myers, p. 4, Ins. 1-4.

¹¹² ACSC Ex. 3, Direct Testimony of Karl J. Nalepa, p.38, Ins. 6-10.

¹¹³ APT Rebuttal, Jeffrey S. Knights, Exhibit JSK-R-6.

¹¹⁴ APT Rebuttal, Jeffrey S. Knights, p. 16, Ins. 20-21.

The Commission has reviewed this issue in a previous case involving Atmos Mid – Tex, a division of Atmos Energy Corporation, GUD No. 9670.¹¹⁵ Atmos Mid – Tex has been before the Commission subsequent to the above rate case in two subsequent rate cases (GUD No. 9762 and 9869) where functionalization of assets between the two divisions was not an issue. Mr. Nalepa did not provide sufficient explanation why he contends there is no benefit to the customer. The Examiners are not inclined to make a recommendation that the Commission has already reviewed and approved with no new evidence presented. As a result, the Examiners recommend the Commission deny ACSC's proposed removal of this project and find that the transfer of assets is just and reasonable.

b. Prepayments

Introduction

Prepayments are a component of rate base. As part of its rate-base calculation, Atmos Pipeline – Texas included prepayments in the amount of \$4,013,773.¹¹⁶ ACSC, the City of Dallas, and ATM all contended that an adjustment should be made to prepayments to exclude an amount related to progress payments for compressor equipment. In response to discovery requests, Atmos Pipeline – Texas explained that compressor equipment is ordered six to nine months prior to delivery and the manufacturers require progress payments as the equipment is manufactured. The company explained that as progress payments are made the amounts are charged to prepayments. Once the equipment is delivered the company makes a final payment and the prepaid amounts are moved to the capital project account.¹¹⁷

The utility indicated that this booking process had been used in the context of progress payments for six items purchased from January 2009 through July 2010.¹¹⁸ The company also noted that this type of capital project is recurring.¹¹⁹ The company also explained that once the equipment is delivered four to seven months elapse before it is placed in service.¹²⁰ In response to a discovery request from ATM, the company explained that the booking process is supported by the FERC USOA. Specifically, the company maintained that the General Instruction 11, set out in Figure 8.1 below, of the FERC USOA provided support for its treatment. The utility also noted that it does not take ownership and legal liability of the pipe or compressor equipment until it is delivered to the company.¹²¹

¹¹⁵ Final Order GUD No. 9670, FOF 204 & PFD ps. 81 & 82.

¹¹⁶ Atmos Ex. 3, Schedule B, ln. 9.

¹¹⁷ ACSC Ex. 3, Attachment F, APT Response to ACSC RFI 2-04.

¹¹⁸ ATM Ex. 42, Atmos Response to RFI No. 3-21.

¹¹⁹ ACSC Ex. 3, Attachment F, APT Response to ACSC RFI 2-04.

¹²⁰ ATM Ex. 41, Atmos Response to RFI No. 3-22.

¹²¹ ATM Ex. 42, Atmos Response to RFI No. 3-21, p. 2

Figure 8.1
General Instruction 11, FERC USOA

General Instruction 11. *Accounting to be on an accrual basis.*

- A. The utility is required to keep its accounts on the accrual basis. This requires the inclusion in its accounts of all known transactions of appreciable amount which affect the accounts. If bills covering such transactions have not been received or rendered, the amounts shall be estimated and appropriate adjustments made when the bills are received.
- B. When payments are made in advance for items such as insurance, rents, taxes or interest, the amount applicable to future periods shall be charged to account 165, Prepayments, and spread over the periods to which applicable by credits to account 165, and charges to the accounts appropriate for the expenditures.

Issues Raised by the Intervenors

The City of Dallas, ACSC, and ATM challenged the entry of this expense in prepayments. The City of Dallas argued that the utility seeks prepayments for capital expenditures for plant not yet in service. Mr. Pous argued that this was equivalent to seeking rate-base treatment for construction work in progress (CWIP) and was inappropriate. CWIP is only allowed in rate base upon a showing of significant financial harm absent its inclusion.¹²² Mr. Nalepa, who testified on behalf of ACSC, and Mr. Carver, who testified on behalf of ATM echoed the same concern. The Intervenors also alleged that inclusion of these amounts in rate base may result in double counting.

Mr. Nalepa cited specific Railroad Commission Rule, Rule 7.5212 that imposes a particular evidentiary burden on the utility for CWIP: A utility may be permitted to include CWIP in its rate base only where necessary to the financial integrity of the utility.¹²³ He also noted that the FERC USOA used as an example of FERC Account 107, Construction Work in Progress, compressor station construction projects.¹²⁴ He concluded that these expenses are costs that shareholders are responsible for until the plant is used and useful in providing service to ratepayers.¹²⁵ Mr. Carver noted that in his experience he could not recall other utilities recording progress payments to the prepayments account and seeking to include such amounts in rate base.¹²⁶

ATM and ACSC also noted that compressor equipment is not the same category of equipment described in General Instruction 11 quoted in Figure 8.1, above. That instruction applies to insurance, rents, taxes or interest that are recurring expense items. Compressor

¹²² City of Dallas Ex. 1, Direct Testimony of Jacob Pous, p. 6, lns. 1 – 11.

¹²³ 16 Tex. Admin. Code § 7.5212 (2010).

¹²⁴ ACSC Ex. 3, Direct Testimony of Karl J. Nalepa, p. 10, lns. 7 – 10.

¹²⁵ ACSC Ex. 3, Direct Testimony of Karl J. Nalepa, p. 11, lns. 8 – 9.

¹²⁶ ATM Ex. 1, Direct Testimony of Steven C. Carver, p. 11, lns. 1 – 2.

equipment is fundamentally different as it is a capital project.¹²⁷ Mr. Nalepa noted that the fact that the company does not take ownership or legal liability of the pipe or compressor equipment until it is delivered is irrelevant. He concluded that the Commission rules and FERC USOA guidelines do not make ownership of an asset the determining factor for accounting treatment for CWIP. It is the character of the asset or expense that determines the treatment.¹²⁸ ATM suggested that progress payments may be treated as either a regulatory asset or the progress payments could be recorded as an Allowance for Funds Used During Construction (AFUDC).¹²⁹

ACSC, the City of Dallas, and ATM agreed that these progress payments should be excluded from rate-base consideration until it is placed in service.¹³⁰ The three Intervenors agreed that the adjustment would result in a reduction of \$1,915,506 to the prepayment amount included in the company's calculation of rate base.

Atmos Pipeline – Texas Response

In response, Mr. Peterson testified that the company's accounting treatment of progress payment is consistent with the FERC USOA.¹³¹ He argued that the company correctly included this amount in prepayments because the company has provided this capital for financing purposes. He responded to allegations made by the Intervenors that the inclusion of prepayments would result in double counting: the prepayment amounts for ordered equipment do not overlap with the timing of when the equipment is booked to plant in service. He also noted that data provided in response to discovery supported the test-year-prepayment request. The average prepayment amount for the twelve-month period ended March 2009 was \$2,215,599. This was comparable to the prepayment amount included in this case of \$2,213,220.¹³²

Examiners Recommendation

The Examiners find that Atmos Pipeline – Texas has not established that the amounts included in this case for prepayments are just and reasonable. The Examiners are not concerned that if the Commission permits the inclusion of these amounts in prepayments that there will be a double counting. If they are included in prepayments, they should, of course, not be included in the subsequent interim rate adjustment filing.

On the other hand, if the progress payments are properly excluded from prepayments the interim rate adjustment ensures that the investment will be recovered as soon as the plant is placed in service and the company files its subsequent interim rate adjustment. Thus, the company will be able to timely recover its investment as soon as the equipment is placed in service and the interim rate adjustment reflecting this investment is approved. The company

¹²⁷ ACSC Ex. 3, Direct Testimony of Karl J. Nalepa, p. 11, ln. 10 – p. 12, ln. 12; ATM Ex. 1, Direct Testimony of Steven C. Carver, p. 10, lns. 21 – 24. Mr. Pous also notes that this is a capital project. City of Dallas Ex. 1, Direct Testimony of Jacob Pous, p. 6, lns. 4 – 5.

¹²⁸ ACSC Ex. 3 Direct Testimony of Karl J. Nalepa, p. 12, lns. 13 – 21.

¹²⁹ ATM Ex. 1, Direct Testimony of Steven Carver, p. 11, ln. 3 – 15.

¹³⁰ City of Dallas, Ex. 1, Direct Testimony of Jacob Pous, p. 5, ln. 11 – p. 10, 7, ln. 91.

¹³¹ Atmos Ex. 21, Rebuttal Testimony of Thomas H. Peterson, p. 9, lns. 6 – 9.

¹³² Atmos Ex. 21, Rebuttal Testimony of Thomas H. Peterson, p. 10, lns. 15 – 21, Exhibit THP-R-1; ATM Ex. 42, APT Response to RFI No. 3-19.

does not contend that CWIP is not allowed where the utility has not made a showing of harm. In this case, the Intervenor has established that the expense is an expense related to CWIP.

Sound ratemaking principles limit the inclusion of expenses related to capital equipment until it is placed in service. Among those principles, is the possibility that the equipment may not ultimately be placed in service. As no evidence has been presented that the company will suffer financial harm, and the company may recover those expenses as part of its subsequent interim rate adjustments, the Examiners find that the progress payments for the compressor equipment should be removed from the calculation of the company's rate base. Furthermore, in light of the interim rate adjustment statute, ATM's alternative that would allow progress payments to be included as an expense amount for AFUDC or as a regulatory asset is unreasonable. In light of the GRIP statute, such treatment is simply not necessary. Further, no party – neither the utility nor the Intervenor – calculated an appropriate amount to be included in AFUDC.

Mr. Petersen argued that the prepayment amount included in this proceeding is consistent with the prepayment amounts shown for the twelve-month period ended March 31, 2009. While this may be true, it is also evident from the record that the company recorded progress payments in 2009.¹³³ Thus, it is not surprising that the amounts for the test year match the amounts recorded for the twelve-month period ended March 31, 2009. In fact, in response to discovery request seeking a list of all items that were booked in a similar fashion from 2007 through 2010, it appears that the company used this booking methodology from June 2009 through July 2010. No progress payments appeared to have been booked to the prepayment account from 2007 through June of 2009.¹³⁴ The adjustment reduces prepayments by \$1,916,506. Due to the impact on the calculated taxes included in the cash working capital analysis, the overall impact on rate base is a reduction of \$1,918,831. The stand alone impact on the company's rate request is a reduction of approximately \$257,954 to the revenue requirement.

c. Accumulated Deferred Income Tax (ADIT)

(A) Introduction

Deferred taxes arise because of timing differences between recognition of certain items for book purposes versus tax purposes.¹³⁵ A credit operates as a decrease to rate base in that it represents a cost-free source of capital. A debit represents tax payments that the utility has funded before they are collected from customers.

An example of an accumulated deferred income tax *credit* is the entry for taxes in excess of book depreciation. For ratemaking purposes, the utility collected an amount of depreciation expense and associated taxes from ratepayers. The amount collected is predicated upon the useful life of the asset using the straight-line method of depreciation. On the other hand, for income tax purposes, accelerated depreciation methods are allowed resulting in a utility paying less income tax. Ratepayers pay the income tax rates as if accelerated tax depreciation benefits

¹³³ ATM Ex. 42, APT Response to ATM RFI No. 3-21.

¹³⁴ ATM Ex. 42, APT Response to ATM RFI No. 3-21.

¹³⁵ Natural Gas Rate Review Handbook, p. 18.

did not exist. The result is that the company enjoys the benefit of the difference between the actual taxes paid and the amount collected from ratepayers.

An example of an accumulated deferred income tax *debit* is the entry for accumulated taxes for contributions in aid of construction. Certain ratepayers make contributions to the utility for the construction of specific facilities, which are used to serve that particular customer or customers. The income for contributions in aid of construction operates as a reduction to plant costs. The payments from the customers are part of the company's revenue stream and are considered taxable income. As a result, the company was required to pay taxes. Those taxes, however, were not part of the previously approved rates and, in essence, the shareholder was required to provide the funds to pay the taxes. Accordingly, it is included as a debit entry for accumulated deferred income tax. It operates to increase rate base and the company should receive a return on those funds.

(B) ADIT Adjustments Required to Conform to Expense Adjustments

Atmos Pipeline – Texas included an ADIT credit associated with various incentive compensation programs of the company. ATM and ACSC argued that certain adjustments should be made. ATM and ACSC argued that certain adjustments to the ADIT calculation are required if the Commission determines that all incentive compensation should be removed. In section 10, below, the Examiners considered adjustments related to incentive compensation. The Examiners concluded that no adjustment should be made to the company's cost of service calculation regarding incentive compensation. Accordingly, ADIT adjustments related to the various incentive compensation programs (Variable Pay Program ["VPP"], Management Incentive Plan ["MPP"], and Long Term Incentive Plant ["LTIP"]) are not required. Additionally, ATM and ACSC argued that an adjustment to ADIT was required as a result of ATM's recommendation that expenses associated with the Supplemental Executive Benefit Plan ("SEPB") should also be removed.¹³⁶ Similarly, the Examiners concluded that Atmos Pipeline – Texas has established that those expenses are just and reasonable. Accordingly, no adjustment to ADIT is required.

The Examiners concur, however, that if an adjustment is made to any of these programs a conforming change must be made to the ADIT calculation. The company's own treatment of the ADIT component of VPP, MPP, and SEPB components that have been voluntarily removed is consistent with this recommendation. The Examiners note that it appears the only argument made by the Intervenor in this context is consistency with the other adjustments made in this case. While other analysis of the ADIT entries may merit consideration of an adjustment, no other basis or allegation was presented in this case for an adjustment.

(C) Charitable Contribution Carryover

ATM raised an issue regarding the inclusion of an ADIT debit reserve included for charitable contributions in the amount of \$279,372.¹³⁷ Mr. Peterson, on behalf of Atmos

¹³⁶ ATM Ex. 2, Direct Testimony of Steven Carver, p. 24, ln. 1 – p. 25, ln. 2 & p. 25, ln. 15 – ln. 4; ACSC Ex. 2, p. 8, ln. 9 – p. 9, ln. 18.

¹³⁷ ATM Ex. 1, Direct Testimony of Steven Carver, p. 25, lns. 3 – 14 & p. 28, ln. 15 – p. 29, ln. 28..

Pipeline – Texas indicated that the debit balance had been removed.¹³⁸ The fact that this was removed is reflected in the company's filings and no further adjustment is required.¹³⁹

(D) Construction Work In Progress (CWIP).

The company proposed that all ADIT related to CWIP be eliminated for purposes of this proceeding. ATM challenged the reasonableness of this approach. Mr. Carver testified that while capital projects are under construction, Atmos Pipeline – Texas records various transactions using different required accounting methods for calculating and capitalizing costs. He alleged that these accounting methods result in timing differences that give rise to the recording of CWIP related to ADIT reserves. He contended that upon project completion and placement in service, the company included the timing differences in the tax fixed asset system which has the effect of transferring the CWIP ADIT reserve to the Fixed Asset Cost ADIT and Depreciation ADIT reserve. Atmos Pipeline – Texas does not recognize any of the CWIP ADIT reserve as an offset to rate base, but does reduce rate base for the Fixed Asset and Depreciation ADIT reserve. He contended that although the company transfers the investment in completed construction projects from CWIP to plant in service on a monthly basis, the transfers of CWIP related ADIT reserve to the Fixed Asset and Depreciation ADIT reserves only occurs when the company files a tax return in June of the year following the fiscal year end. Mr. Carver concluded that this resulted in a significant disconnect in the timing of the company's closing of completed capital projects to plant in service and transferring CWIP ADIT reserves to plant-related ADIT reserves. Thus, he recommended that a portion of the CWIP ADIT reserve balance be used to reduce the related plant in service included in rate base at the end of the test year.¹⁴⁰

Mr. Peterson responded by noting that Mr. Carver's proposal is inconsistent with GUD No. 9869. Further, he noted that Mr. Carver singled out for special ratemaking treatment one ADIT item. He contended that this is inappropriate because it fails to consider the effect of the other ADIT items that may offset the effect of this single item identified by ATM.¹⁴¹

The Examiners find that the company has not included CWIP in its calculation of rate base. This is consistent with the treatment required of CWIP asserted by the Intervenor in this proceeding. The company has removed the ADIT liability related to CWIP from its calculation of ADIT. The Examiners find that ATM's proposed adjustment is inconsistent with the treatment of other assets, and the treatment afforded in prior proceedings related to other divisions of Atmos Energy Corporation. Accordingly, the Examiners recommend that the proposed adjustment be rejected.

(E) Tax Accounting Method Change (Form 3115)

In June of 2010, Atmos Energy submitted Form 3115, an application to receive approval for a different accounting methodology for certain repair and maintenance costs. This request was made after the end of the test year in this case. ATM and the City of Dallas contended that

¹³⁸ Atmos Ex. 21, Rebuttal Testimony of Thomas H. Peterson, p. 2, lns. 15 – 23.

¹³⁹ Atmos Ex. 3, Second Errata, Schedule B-3.1, ln. 30.

¹⁴⁰ ATM Ex. 1, Direct Testimony of Steven C. Carver, p. 26, ln. 5 – p. 34, ln. 3.

¹⁴¹ Atmos Ex. 21, Rebuttal Testimony of Thomas H. Peterson, p. 6, ln. 18 – p. 7, ln. 4.

the ADIT calculation should reflect this change for certain components of the ADIT calculation. Mr. Brosh, who testified on behalf of ATM contended that substantial tax deferral opportunities are available to a utility through adoption of these changes. The City of Dallas reiterated these arguments.¹⁴² Mr. Brosch and Mr. Pous argued that this was a known and measurable change and an adjustment to the cost of service calculation should be made to reflect this change. They each argued that two ADIT entries should be adjusted to capture this allegedly known and measurable change.

Mr. Peterson and Mr. McDonald responded on behalf of Atmos Pipeline – Texas and contended that such adjustments violate accounting requirements and that it is inappropriate to make only one adjustment and not update the entire rate base to June 30, 2010. Mr. McDonald argued that the accounting standards contained in ASC Topic 740-10-10-1 required that deferred taxes be recorded when events have been recognized in an entity's financial statements or tax returns. The deferred taxes, therefore, were properly recorded in the month-end accounting entries for June 2010. Mr. McDonald argued that the position taken by the Intervenor would require that the utility would constantly have to revise its prior ADIT balances based upon future or anticipated changes. Further, he contended that the proposal of the Intervenor results in recognition of ADIT in rate base prior to the company actually securing the tax deferral.

The Examiners find that the company has established that its calculation of ADIT balances based upon tax calculations in effect during the test year are just and reasonable. The Intervenor would require that the ADIT balances be updated after the close of the test year prior to the hearing. The Examiners do not find that all rate base components need to be adjusted in the event ADIT was recalculated. The Examiners find, however, that it is unreasonable to focus on a single component of the ADIT calculation as of June 2010. A full recalculation of the ADIT balance should be conducted. In this case, a full recalculation of the ADIT balances as of June 2010 would operate to increase rate base.¹⁴³

(F) Federal Income Tax Law Change (Small Business Jobs Act)

On September 27, 2010, the Small Business Jobs Act (H.R. 5297) was signed into law. The act provides for a retroactive extension of 50% bonus depreciation until the end of 2010. Absent this extension, bonus depreciation expired on December 31, 2009. The regulation allows taxpayers to immediately expense a portion of costs that would normally be a capital expenditure subject to recovery over an extended period through depreciation deductions. The law was not in effect during the test year. Thus, the ADIT calculations made did not reflect these changes.

ATM contended that the ADIT balances should reflect this change in tax law. Atmos Pipeline – Texas repeated the same issues raised in section (E) above. The Examiners find, as in the case of tax accounting method change, that the company has not yet realized a deferral of tax from bonus depreciation extension. The company witness explained that the company made estimated tax payments in September 2010. Those payments were based on the prior tax law. In November, the company requested a refund, and as of the date rebuttal testimony was filed,

¹⁴² City of Dallas, Ex. 1, Direct Testimony of Jacob Pous, p. 22, lns. 19 – 26.

¹⁴³ Atmos Ex. 20, Rebuttal Testimony of Pace McDonald, Exhibit PM-R-2.

the refund had not been provided. Again, the Examiners find that the proposed adjustment would require constant recalculation of ADIT in rate proceedings. Further, an update of the ADIT figures based upon a tax change effective after the test year should be accompanied by revision of all ADIT figures. Accordingly, the Examiners recommend that the proposed adjustment be rejected.

d. FAS 106 Liability

Introduction

The injuries and damages reserves are amounts in the company's reserve accounts that represent capital contributed by ratepayers. Thus, it operates as a deduction to rate base. The amount the company included for injuries and damages in this proceeding was \$40,092.¹⁴⁴ Those amounts were the amounts included in Account 228.2, set out in Figure 8.2, below.

Figure 8.2
FERC USOA Account 228.2

This account shall be credited with amounts charged to account 925, Injuries and Damages, or other appropriate accounts, to meet the probable liability, not covered by insurance, for deaths or injuries to employees and others, and for damages to property neither owned nor held under lease by the utility.

Certain items operate as a deduction to rate base. ATM contended that an adjustment should be made to the entry for injuries and damages to recognize amounts for FAS 106 liability. Mr. Carver argued that the FAS 106 liability was a form of zero cost of capital, which should operate to reduce rate base.¹⁴⁵ The issue of FAS 106 liability focuses upon post-employment benefits other than pensions. In other words, this issue does not involve expenses related to pensions for retirees. Instead, it focuses upon retiree health care, dental care, or life insurance.¹⁴⁶ FAS 106 requires that utilities account for post-retirement benefits on an accrual basis during the working lives of the employee.

Issues Raised By Intervenors

ATM proposed that FAS 106 liability be recognized as a rate base offset.¹⁴⁷ Mr. Carver explained that costs are quantified pursuant to the requirements of FAS 106 by the utility. The accrual journal entry does not, however, represent the actual out-of-pocket expenditure of the utility. The actual out-of-pocket expenditure may be lower or higher. He contended that the excess of the accrued costs over the actual expenditure created a form of capital for the company and that the FAS 106 liability balances represented a form of zero cost capital that should be recognized as an offset to rate base.¹⁴⁸ He noted that for fiscal year 2010, the out-of-

¹⁴⁴ Atmos Ex. 3, Schedule B, ln. 15, col. (e) and Schedule B-2.

¹⁴⁵ ATM Ex. 1, Direct Testimony of Steven C. Carver, p. 15, lns. 5 – 6.

¹⁴⁶ TR Vol. II, p. 133, lns. 11 – 14.

¹⁴⁷ ATM Ex. 1, Direct Testimony of Steven C. Carver, p. 16, ln. 17.

¹⁴⁸ ATM Ex. 1, Direct Testimony of Steven C. Carver, p. 18, lns. 8 – 9.

pocket expenditures represents only 20.3% (SSU), 12.6% (Mid-Tex direct) and 7.8% (Atmos Pipeline – Texas) of the FAS 106 accrual-basis cost. He argued that these funds represent a source of cash that Atmos Pipeline – Texas may use for general corporate purposes. It is the accumulation of this excess that represents the FAS 106 liability and it is these funds that ATM proposes be recognized as a rate base offset.¹⁴⁹ The FAS 106 liability balances would decrease the company's rate base by approximately \$5,753,796.¹⁵⁰

Mr. Carver argued, in the alternative, that if the external funds were placed in a restricted external trust, that a rate-base adjustment should not be made. In other words, ATM requested that Atmos Pipeline – Texas should be required to establish and commence contributing to an external trust restricted for the purpose of satisfying retiree other post-employment benefit (“OPEB”) obligations. Mr. Carver argued that this represented a remedy that is fair and equitable to the ratepayers, shareholders and retirees. He noted that this is what has been required in other states where other Atmos Energy divisions provide natural gas service: Colorado, Iowa, Kansas, Mississippi, Missouri, Tennessee, and Virginia. He maintained that if the Commission determines that an external fund be established, the ADIT asset related to FAS 106 should be removed.¹⁵¹

In response, Mr. Peterson noted that the proposal of Mr. Carver represented a departure from past Commission treatment of FAS 106 liability. He contended that the Commission has been consistent in its treatment of OPEB in all cases involving Atmos' West Texas Division and that Atmos Mid – Tex has adopted the same treatment of FAS 106 liability. He also contended that the proposed adjustment was selective. ATM has not proposed a similar base rate treatment of the net pension asset on the balance sheet and that such an adjustment would increase rate base more than FAS 106 liability would decrease it.¹⁵²

Examiners' Recommendation

The Examiners find that Atmos Pipeline – Texas has not established that its treatment of FAS 106 liability is reasonable. In response to discovery, the company simply stated that as to FAS 106 accrual liability, the amounts were not included in the rate base calculation.¹⁵³ Additionally, the company confirmed that the company has access to the funds represented by the FAS 106 liability until those funds are required to pay benefits or on behalf of retirees.¹⁵⁴ The company confirmed that the funds related to FAS 106 liability have not been deposited in any external fund or restricted account that limits the use of those funds to the payment of benefits to or on behalf of retirees.¹⁵⁵ The company witness never addressed the ratemaking issue raised by ATM: Ratepayers have provided funds for FAS 106 liability and, absent an external fund or restricted account, those funds are available to the utility. The allegation is that these funds represent capital provided by the ratepayer.

¹⁴⁹ ATM Ex. 1, Direct Testimony of Steven C. Carver, p. 19, ln. 1 – p. 20, ln. 2.

¹⁵⁰ ATM Ex. 1, Direct Testimony of Steven C. Carver, p. 16, lns. 11 – 12.

¹⁵¹ ATM Ex. 1, Direct Testimony of Steven Carver, p. 20, ln. 3 – p. 21, ln. 19.

¹⁵² Atmos Ex. 1, Direct Testimony of Thomas H. Peterson, p. 23, ln. 2 – p. 24, ln. 2.

¹⁵³ ATM Ex. 47, APT Response to RFI No. 4 – 03, p. 2.

¹⁵⁴ ATM Ex. 75, APT Response to RFI No. 10 – 43, p. 1.

¹⁵⁵ *Id.*

Rather than deduct those funds from rate base, however, the Examiners recommend that an external fund be established as proposed by ATM in its alternative recommendation. The evidence in the record, and not rebutted by Atmos Pipeline – Texas, is that other states where other Atmos Energy divisions provide natural gas service (Colorado, Iowa, Kansas, Mississippi, Missouri, Tennessee, and Virginia) have required that an external fund be established. The Examiners do not, however, recommend that an additional adjustment be made to remove the ADIT debits associated with those funds. The company should be allowed to recognize the ADIT debit associated with those funds to ensure that all expenses associated with the external fund are available to meet the needs of the company's retirees. The recommendation of the Examiners does not impact the rate base as calculated by the utility.

e. Storage Gas

Atmos Pipeline – Texas proposed a 13-month average ended March 31, 2010 for working gas in storage (WGIS) value.¹⁵⁶ The period ended March 31, 2010 is consistent with the test year period the applicant used for other accounts in the *Statement of Intent* work papers and schedules. Atmos Pipeline – Texas proposed WGIS to be valued at \$150,781,860.¹⁵⁷

Mr. Nalepa, on behalf of ACSC, argues that the value is too high as prices are declining and have declined since Atmos Pipeline – Texas injected gas into storage during the 13-month period. Mr. Nalepa proposes a 13-month average ended June 30, 2010.¹⁵⁸ He feels this better reflects the current and future natural gas prices. Mr. Nalepa, based on his recommendation, proposed an \$8,515,612 reduction in WGIS value. Mr. Nalepa cites the New York mercantile Exchange ("NYMEX") gas price futures as evidence that prices will remain low.¹⁵⁹ ACSC contends since the filing of this case was not until September, Atmos Pipeline – Texas could have made the adjustment because it was known and measureable.

Atmos Pipeline – Texas claims ACSC's adjustment goes beyond the test year used in the case. In addition, Atmos Pipeline – Texas contends ACSC does not recognize the fact that there were changes in the volumes for the previous three years and that the actual test year investment in working gas in storage contained below average volumes and prices that were lower than prior years.¹⁶⁰

The Examiners conclude that using the 13-month average is not in question, rather are natural gas prices on the decline and, if so, does the June 30, 2010 time period better reflect the current, and looking forward prices, of natural gas. ACSC's proposed reduction in WGIS value uses a period beyond the March 31, 2010 test year period by three-months.

The proposed 13-month period suggested by ACSC and the reasoning behind its use causes concern for the Examiners. First, the Examiners do not believe the underlying issue on the value of WGIS is not whether the March 31st test year should be used as opposed to the 13-months ended June 30th. The question is whether or not ACSC is correct on its contention that

¹⁵⁶ Atmos Ex. 3, Sch. E-4.

¹⁵⁷ *Id.*

¹⁵⁸ ACSC Ex. 3, Direct testimony of Karl J. Nalepa, p. 14, Ins. 3-4.

¹⁵⁹ *Id.*, Ins. 8-10.

¹⁶⁰ Atmos Ex. 21, Rebuttal Testimony of Thomas H. Peterson, p. 12, Ins. 6-13.

natural gas prices will decline further or stay constant at the current level and whether a June 30, 2010, 13-month period best reflects that trend. June 30, 2010 is three months outside the test year period, which is inconsistent with keeping all accounts synchronized with a test year. Second, the Examiners view the reasoning of ACSC that the NYMEX gas futures is an indicator of natural gas prices down the road as 'crystal ball' forecasting. The implied conjecture that NYMEX 'futures' project physical delivered natural gas Hub or index prices for some future period, is flawed. The Examiners find NYMEX gas futures is not an indicator of prices a utility might pay for a physical delivered price in a future period. As a result, the Examiners recommend rejection of ACSC's recommendation.

f. Cash Working Capital (CWC)

(A) Introduction

Cash working capital represents an amount of cash that a utility must have available to meet current obligations as they arise due to the time lag between payment of expenses and collection of revenues. The need for working cash has long been recognized by regulatory bodies and the courts. An allowance of cash working capital, however, is not guaranteed as a matter of course and the utility carries the burden of establishing the need for cash working capital. Atmos Pipeline – Texas prepared a lead-lag study to determine the cash working capital needs of the Atmos Pipeline – Texas system. A lead-lag study empirically identifies the difference in timing between outward cash flow for labor, materials and supplies, inventory, other expenses, and inward cash flow of revenue from payments to customers.

The cash working capital analysis measures payment and collection time lags to determine the amount of cash working capital used to provide utility service. This analysis compares two different lags. The lag between (1) the provision of service to customers and the collection of cash from customers is compared to the lag between (2) the recording of expenses and the payment of cash by the company for those expenses.¹⁶¹

Cash working capital requirements may be positive or negative. Positive working capital is investor-supplied. In contrast, negative working capital is funded by the ratepayer and reduces the need for investor-supplied capital and arises when the utility receives customer payments before service is rendered, or when it receives funds before it must satisfy a corresponding liability. To illustrate the concept of cash working capital, if one assumed that the utility paid for natural gas before it supplied the natural gas to the consumer, then the utility would be using positive cash working capital, i.e., money from its investors, to pay for natural gas until the consumer paid the utility. In that case, the investors have an expectation of receiving a reasonable return on its investment. If, however, the consumer paid the utility in advance for use of the product, the company has negative cash working capital and the investor would have no expectation of return because the investor's capital was not being used.

In this proceeding, the overall cash working capital study submitted as part of the *Statement of Intent* indicated that the company was a negative cash working capital. Thus, the company determined that the overall cash working capital was ratepayer funded and should be

¹⁶¹ Atmos Ex. 8, Direct Testimony of Thomas H. Peterson, p. 12, ln. 13 – p. 13, ln. 4.

deducted from rate base. The company estimated that the amount of ratepayer funding cash working capital was \$1,996,335.¹⁶² Several Intervenors argued that the cash working capital was incorrectly calculated and the rate payer funded cash working capital was higher.

(B) Revenue Lag

(a) Revenue Lag for Non-Mid Tex Customers.

In GUD No. 9400, the Commission found that a revenue lag of 37.891 was appropriate for the predecessor in interest of Atmos Pipeline – Texas.¹⁶³ In this proceeding, the City of Dallas and ATM contended that this amount was incorrectly calculated.

The company concluded that the billing lag for all bills not related to Atmos Mid-Tex was 15.64.¹⁶⁴ ATM and ACSC opposed the company's request. Mr. Pous and Mr. Carver contended that the actual billing lag should be shorter. Mr. Pous noted that the utility has issued bills to this category of customers in as few as ten business days. Thus, the company demonstrated that it is able to issue bills on the tenth business day of the following month, yet the company has elected to rely upon billings as long as twelve business days. He implied that this was done in order to manipulate its request in this case. For purposes of this proceeding Mr. Pous argued that a billing lag of less than ten days is possible. Nevertheless, he concluded that a billing lag of ten days is appropriate in this case. Once that adjustment is made to the company's workpapers, and once holidays are taken into account, the meter reading to billing lag for this customer class is 13.93 days instead of 15.64 as days proposed by the company.¹⁶⁵

Similarly, Mr. Carver argued that the company failed to establish that a billing lag of 15.64 days was reasonable. He contended that the customer base did not justify a complex billing process. Additionally, he noted that the proposed rate design should result in a simplified billing process that was not recognized in the cash working capital study.

In response, Mr. Peterson stated that the billing lag was calculated using actual bill dates in the test year. He contended that Mr. Pous and Mr. Carver failed to consider the terms of the contracts between Atmos Pipeline – Texas and its customers. The contracts generally provide for billing on or about the 15th of the month. He observed that a review of the test-year billing dates confirmed that bills were issued within one working day of the 15th of the month.¹⁶⁶ Additionally, Mr. Peterson explained that the methodology employed in this case is the same methodology employed in GUD Nos. 9762 and 9869.¹⁶⁷

The Examiners find that Atmos Pipeline – Texas has established that the billing lag is just and reasonable. The company established that the billing lag was calculated consistent with prior Commission cases. The company also established that the lag was dependent, in part,

¹⁶² Atmos Ex. 3, Schedule E-1, ln. 23.

¹⁶³ City of Dallas, Ex. 1, Direct Testimony of Jacob Pous, p. 9, lns. 15 – 18.

¹⁶⁴ Atmos Ex. 3, THP – CWC 2, ln. 3, col. c.

¹⁶⁵ City of Dallas, Ex. 1, Direct Testimony of Jacob Pous, p. 9, ln. 20 – p. 11, ln. 2.

¹⁶⁶ Atmos Ex. 21, Rebuttal Testimony of Thomas H. Peterson, p. 13, ln. 1 – p. 14, ln. 9.

¹⁶⁷ Atmos Ex. 21, Rebuttal Testimony of Thomas H. Peterson, p. 14, ln. 11 – p. 16, ln. 10.

upon the structure of the contracts. The proposed adjustment of the Intervenor's was inconsistent with those contractual arrangements.

(b) Revenue Lag for Mid-Tex

Mr. Petersen explained that Mid-Tex and Atmos Pipeline – Texas are both operating divisions within Atmos Energy Corporation and that the Commission has calculated the lag on payments from Atmos Mid – Tex and Atmos Pipeline – Texas differently than it has calculated the lag on payments to other unrelated entities. He contended that he followed the Commission's method of calculating a lag on the Atmos Mid – Tex payments to Atmos Pipeline – Texas in calculating the revenue lag.¹⁶⁸ The City of Dallas disagreed that reliance on a previously approved methodology was a reasonable method for calculating the revenue lag for Atmos Pipeline – Texas.

Mr. Pous, who testified on behalf of the City of Dallas, argued that the company-proposed proxy employed invoice periods as long as thirty-one (31) days after service was provided. He maintained that including such invoice periods was unreasonable. He argued that the calculation of the Atmos Mid – Tex revenue lag should be based upon what he determined were more appropriate invoicing time frame. He adjusted any invoice that included an invoice date longer than 20 days. That adjustment resulted in a 39.17 revenue lag, as opposed to 40.40 days.¹⁶⁹ Mr. Carver also argued that the billing lag for Atmos Mid-Tex was excessive.

In response, Mr. Peterson contended that the billing lag for Atmos Mid-Tex was calculated using the methodology adopted in prior cases. The Commission has previously evaluated the lead for Atmos Mid – Tex when it receives services from Atmos Pipeline – Texas. The company asserted that since Atmos Pipeline – Texas and Atmos Mid – Tex represent opposite sides of the same transaction, it was appropriate to follow the methodology employed in prior proceedings.

The Examiners find that Atmos Pipeline – Texas has established that the methodology employed to determine the revenue lag for Atmos Mid – Tex was based upon the methodology employed in prior proceedings. No evidence was presented to refute this fact.

(c) Revenue Lag if the Revenue Credit is Approved

Mr. Pous also argued that if a revenue credit is approved for the purpose of setting rates in this proceeding, as proposed by Atmos Pipeline – Texas, the overall revenue lag should be set at 39.17 days. He maintained that the company's approach precluded implementation of a calculation that would have assigned the longer revenue lag days associated with those customers other than Atmos Mid – Tex. He recommended that if the Commission determines that the revenue credit approach should be retained then the revenue lag of 39.17 day should be utilized for determining cash working capital requirements.¹⁷⁰ The Examiners find that the overall revenue lag should be adjusted if a revenue credit is approved in this case. As the

¹⁶⁸ Atmos Ex. 8, Direct Testimony of Thomas H. Petersen, p. 15, Ins. 1 – 23.

¹⁶⁹ City of Dallas Ex. 1, p. 11, ln. 6 – p. 12, ln. 15.

¹⁷⁰ City of Dallas Ex. 1, p. 12, ln. 17 – p. 13, ln. 15.

Examiners have recommended approval of a revenue credit the Examiners recommend that the revenue lag be adjusted accordingly.

(C) Expense Lag

(a) Adjustment for Incentive Compensation

ATM recommended disallowance of all incentive compensation costs, including the Atmos Pipeline – Texas direct expenses for MIP/VPP. The recommendation is discussed in section 10 below. If the Commission determines that those expenses are to be excluded from the cost of service calculation, Mr. Carver recommended that a corresponding change should be made to the cash working capital.¹⁷¹ The Examiners recommend approval of the incentive compensation expenses as proposed by the company. The Examiners find, however, that if the incentive compensation is disallowed a corresponding change to the cash working capital calculation is just and reasonable.

(b) FAS 106: Recalculate or Remove from CWC analysis

Mr. Pous argued that the company incorrectly calculated the FAS 106 component of CWC. He contended that the FAS 106 is a form of deferred compensation and has a long corresponding service period. He noted that the PUC has recognized this fact. Accordingly, he recommended an adjustment to the expense lag associated with this component of CWC.¹⁷²

Mr. Carver criticized Atmos Texas – Pipeline for its inclusion of unfunded FAS 106 accrual.¹⁷³ He argued that the FAS 106 accrual was a non-cash transaction that should be excluded from the cash working capital analysis. He maintained that by definition, all “non-cash” transactions recorded by the utility should be excluded from any lead lag study of cash flows. Accordingly, the unfunded FAS 106 accrual should be excluded from the cash working capital analysis.¹⁷⁴

Mr. Peterson responded to the arguments raised by Mr. Pous regarding the recalculation of the expense lag associated with FAS 106. He argued that it was flawed because it selectively removes pension expense and FAS 106 expense for special treatment and overstates the payment lag on these two items. Further, he contended that it was at odds with the methodology approved in GUD Nos. 9670, 9762, and 9869. The methodology approved minimizes expense in calculating the expense lag by grouping these items into one category. Further, he contended that including the three years required to vest in the pension plan in the calculation of the expense lag was fundamentally flawed.¹⁷⁵

¹⁷¹ ATM Ex. 1, Direct Testimony of Steven C. Carver, p. 52, ln. 17 – p. 53, ln. 2.

¹⁷² City of Dallas, Ex. 1, Direct Testimony of Jacob Pous, p. 13, ln. 16 – p. 16, ln. 9.

¹⁷³ ATM Ex. 1, Direct Testimony of Steven C. Carver, p. 56. Mr. Carver also criticized the inclusion of an immaterial amount of uncollectible expense accruals. No specific reference was made to an account or amount and the allegation was unsubstantiated and is thus disregarded. Unsubstantiated allegations of this nature, however, do impact the credibility of the witness.

¹⁷⁴ ATM Ex. 1, Direct Testimony of Steven C. Carver, p. 56, lns. 1- 17.

¹⁷⁵ Atmos Ex. 21, Rebuttal Testimony of Thomas H. Petersen, p. 17 – 19.

In sub-section d above the Examiners recommended that an external fund should be established as recommended by ATM. The Examiners find that the grouping of these accounts for purposes of calculating the CWC is reasonable and has been previously approved by the Commission. Finally, the Examiners find the inclusion of the period required to vest in the pension plan in calculating the proposed expense lag, as proposed by the City of Dallas is unreasonable. For these reasons the Examiners find that the expense lag associated with the FAS 106 expense was correctly calculated and it is appropriate to include expenses related to FAS 106 in the cash working capital calculation.

(c) O&M Non-Labor Expense Lag

The company calculated the lead associated with miscellaneous other Non-Labor O&M expenses using the actual payment clear dates. Mr. Nalepa proposed an adjustment to the miscellaneous other non-labor O&M expense lead. He used the latter of the actual payment date or the due date in calculating the expense lead for O&M non-labor.¹⁷⁶ Mr. Peterson responded by asserting that the use of the methodology proposed by Mr. Nalepa ignores the realities of process of paying a large numbers of bills. He contended that Mr. Nalepa failed to balance the benefits of delaying all payments to the due date with the increased staffing levels required to actually make that happen. Paying bills when they appear in accounts payable minimizes labor costs. The Examiners find that the company has established that its payment processes are just and reasonable. In light of the large volume of bills, the company processed 19,000 bills during the test year, it is reasonable to pay the bills when they appear in accounts payable.

(d) Ad Valorem Taxes

The company included a working capital component for direct *ad valorem* taxes of Atmos Pipeline – Texas and allocated *ad valorem* taxes for shared services. The cash working capital component associated with *ad valorem* taxes of Atmos Pipeline – Texas was a negative \$4,298,881. The cash working capital component associated with the allocated portion of *ad valorem* taxes from the shared services was a negative \$14,496. The company's proposal is summarized at Table 8.3 below.

Table 8.3
Proposed Cash Working Capital Requirement for Ad Valorem Taxes

Description	Proposal and Proposed Adjustments	TY Expense	Ex. Lag	CWC Req
Direct APT	Proposed by Atmos Pipeline – Texas	\$9,751,968	(203.00)	(\$4,298,881)
	As adjusted by ATM & City of Dallas	\$9,751,968	(213.00)	(\$4,566,098)
	As adjusted ACSC	\$9,751,968	(214.00)	(\$4,592,776)
Allocated	Proposed by Atmos Pipeline – Texas	\$38,578	(179.25)	(\$14,496)
	As adjusted by ATM	\$38,578	(213.00)	(\$18,063)
	As adjusted by City of Dallas	\$38,578	(187.64)	(\$15,383)
	As adjusted by ACSC	\$38,578	(188.37)	(\$14,297)

¹⁷⁶ ACSC Ex. 3, Direct Testimony of Karl J. Nalepa, p. 18, ln. 15 – p. 19, ln. 3.

ACSC, the City of Dallas, and ATM were all critical of the practice employed by the company to pay *ad valorem* taxes before the due date. ACSC noted that the Commission does not have specific guidelines for calculating the component lead-lag days to determine cash working capital requirements. Mr. Nalepa applied the regulations adopted by the Public Utility Commission (PUC) of Texas. The PUC rules provide that the check clear date, or the invoice due date, whichever is later, should be used in calculating the lead-lag days used in a cash working capital study.¹⁷⁷ Mr. Nalepa concluded that it was reasonable to use the latter of the two dates because it best reflects the period of time the utility retains access to the funds. Based upon this conclusion, he determined that eleven days should be added to the expense lag calculation for the calculation of the *ad valorem* tax cash working capital requirement of Atmos Pipeline – Texas direct and *ad valorem* tax the cash working capital requirement of shared services.¹⁷⁸ His calculation resulted in different expense lags for the *ad valorem* tax cash working capital requirement of Atmos Pipeline – Texas direct and the *ad valorem* tax cash working capital requirement allocated from Shared Services.

Mr. Carver, who testified on behalf of ATM, also contended that pre-payment of property taxes was inappropriate for the calculation of the cash working capital requirement of *ad valorem* taxes. He noted that the methodology employed for the property tax payment lag calculation was different from the methodology employed to determine the payment lag for the Gas Utility Pipeline Tax and the Payroll Tax lag day calculation.¹⁷⁹ The methodology employed by Mr. Carver to calculate the expense lag for this category was not explained. The methodology, however, resulted in an expense lag identical for this category of expense for both Atmos Pipeline – Texas and the allocated expense from Shared Services.¹⁸⁰

The City of Dallas leveled the same criticism with regards to *ad valorem* taxes. Mr. Pous argued that payment of invoices before their due date represents unacceptable and inefficient cash management and the company should not be rewarded for poor performance. He recommended recognizing a January 31st payment date for all property tax payments due in January.¹⁸¹ His recommendation resulted in an expense lead for Atmos Pipeline – Texas direct *ad valorem* taxes of 213 days and an expense lead for the allocated *ad valorem* taxes of 187.64 days.¹⁸²

The Examiners find that the company has not established that the expense lag associated with *ad valorem* tax is just and reasonable. Unlike O&M Non-Labor Expense Lag, the company has not asserted that there is a large volume of bills associated with this expense item. Further, the company has not asserted that awaiting the due date to pay this expense imposed a procedural burden on the processing of these bills. Accordingly, the Examiners find that an adjustment to the company's proposal is appropriate and that ATM has accurately calculated that adjustment.

¹⁷⁷ PUC Subst. Rule 25.231(d)(2)(B)(iii)(IV)(c).

¹⁷⁸ ACSC Ex. 3, p. 16, ln. 19 – p. 17, ln. 7.

¹⁷⁹ ATM Ex. 1, Direct Testimony of Steven C. Carver, p. 53, lns. 11 – 14.

¹⁸⁰ ATM Ex. 1, Direct Testimony of Steven C. Carver, SCC-Exhibit 8.

¹⁸¹ City of Dallas Ex. 1, Direct Testimony of Jacob Pous p. 18, ln. 6 -23.

¹⁸² City of Dallas Ex. 1, Direct Testimony of Jacob Pous, p. 18, lns. 20 – 23.

(e) Payroll Taxes

ATM argued that if Atmos Pipeline – Texas incentive compensation (MIP/VPP), discussed below, is excluded from the company's requested cost of service, then the impact of incentive compensation should be removed from the cash working capital calculation. Accordingly, Mr. Carver proposed that an adjustment be made to the company's calculation of payroll expense lag to reflect a consistent treatment.¹⁸³ As noted below, the Examiners do not recommend an adjustment to incentive compensation; accordingly no flow through effect is required to the payroll tax component of CWC. The Examiners agree, however, that if an adjustment is made to incentive compensation a corresponding adjustment to the payroll tax component of CWC must be made.

(f) Gross Margin Tax

Atmos Pipeline – Texas calculated a cash working capital requirement for the gross margin tax of 577,403, based in part, on an expense lag of a negative 48 days.¹⁸⁴ Mr. Petersen explained that an estimated state franchise/margin tax is paid on May 15th with a true-up payment, if required, to be made on November 15th of each year. He noted that since the estimated payment on May 15th is before the midpoint of the year on July 2nd, the tax is paid with a negative lag of 48 days.¹⁸⁵ ACSC and the City of Dallas contended that the expense lag was incorrectly determined.

Mr. Nalepa, who testified on behalf of ACSC, argued that the gross margin tax paid is based on revenue from the prior year. He contended that Atmos Pipeline – Texas records the gross margin tax liability in the year before it pays it, and consequently, that year should be used to calculate the expense lead days. Mr. Pous argued similarly that gross margin taxes are paid in arrears and are not prepayments.¹⁸⁶

Mr. Peterson responded by noting that Mr. Pous and Mr. Nalepa rely on the decision in Public Utility Commission of Texas ("PUC") Docket No. 35717 to support their position that the gross margin tax is paid in arrears and the lag is from the prior year to the payment date in the current year. He noted, however, that subsequent to the PUC's decision in Docket No. 35717, the Comptroller of Public Accounts of the State of Texas issued an opinion that established that the gross margin tax payment is made during the privilege period, which is the year service is being provided.

The Examiners find that the privilege period is the same as the service period and that the company's proposal is consistent with the actual timing of payments and provision of service. Accordingly, the proposed lag of a negative 48 days is just and reasonable.

¹⁸³ ATM Ex. 1, Direct Testimony of Steven C. Carver, p. 53, Ins. 15 – 18.

¹⁸⁴ Atmos Ex. 3, Schedule E-1, ln. 17.

¹⁸⁵ Atmos Ex. 8, Direct Testimony of Thomas H. Petersen, p. 23, Ins. 4 – 10.

¹⁸⁶ City of Dallas Ex. 1, Direct Testimony of Jacob Pous, p. 19, ln. 1 – p. 40, ln. 41.

9. SSU Allocation (Rate Base and Operating Expenses)

Atmos Pipeline – Texas uses a four factor allocation methodology to allocate general plant, materials and supplies, accumulated deferred income taxes, injuries and damages reserve, and certain adjustments to rate base. The four components included in the four factor formula are as follows:

- Gross Direct Property Plant and Equipment
- Number of Customers
- Operating Expenses
- Operating Income

This methodology was adopted in GUD No. 9670 for Atmos Mid – Tex, and affirmed in subsequent cases. The latest proceeding was GUD No. 9869.

ACSC raised a concern regarding the frequency with which those factors are updated. Ms. Cannady noted that the four factor formula would be based upon data for 2009 and applied to the test year ended March 2010. This factor will be in effect for several years. Therefore, she recommended that the SSU allocation factor be based upon an average of the four factors over a four year period. The result of the recommendation is a reduction in the allocation factor from 14.30% to 13.22%.¹⁸⁷

Ms. Myers responded by noting that the four-factor formula was approved in GUD Nos. 9670, 9762, and 9869. She noted that no evidence was provided to show that the methodology employed by the company was somehow inaccurate. She also noted that the methodology proposed by ACSC would impose a different method of allocation of common cost and investments on Atmos Pipeline – Texas that is applicable to other regulated divisions of Atmos Energy Corporation in Texas. This inconsistency may result in under recovery of expenses.

The Examiners find that Atmos Pipeline – Texas has established that the allocation factor is just and reasonable. It is a methodology that has been previously applied in three other cases. Additionally, the Examiners are not aware of any case where the formula to derive an allocation formula requires normalization of the underlying values. The Commission has not previously required that the four factor formula be normalized over a four-year period. The Examiners note that Ms. Cannady prepared Schedule CTC – 4 attached to her prefiled testimony. The schedule relates to the Base Labor Adjustment proposed by Ms. Canady, discussed in section 10 below. In that schedule Ms. Cannady proposed an allocation factor for allocation of Shared Services General Office labor expenses of 14.67%. This allocation factor is higher than the four-factor allocation factor employed by the company in this proceeding and confirms the reasonableness of the company's proposal.

¹⁸⁷ ACSC Ex. 2, Direct Testimony of Constance T. Cannady, p. 6, ln. 1 – p. 8, ln. 7.

10. Operating Expenses**a. Labor Expenses****(A) Base Payroll Expense - Introduction**

Atmos Mid-Tex Pipeline indicated that base labor expenses for the test-year are comprised of four components. Those components are set out in Table 10.1 below and the test-year amounts are set out there. The company made an adjustment to the test-year amounts. The company evaluated expenses at March, 2010 – the last month of the test year. The company annualized those amounts and compared it to the test-year amounts. On that basis the company proposed to increase the test-year base payroll expense.

Table 10.1
Components of Base Labor

	Test-Year Amounts	Adjusted Amounts
Atmos Pipeline-Texas	\$5,442,444	\$5,442,444
Atmos Mid-Tex	\$78,492,252	\$81,586,008
SSU Allocated to APT	\$36,058,576	\$35,586,217
Total APT Labor	\$178,999,861	\$183,227,760

Thus, the company seeks to have rates established based upon a base labor cost that is \$4,227,889 above the test-year level of labor expenses. That is a 2.36% increase over the test-year levels.

(B) Base Labor – Level of Base Labor for SSU*Issue raised by the Intervenors*

The utility contended that the test-year level of labor for shared services was \$36,058,576. Ms. Cannady, who testified on behalf of ACSC, argued that base payroll expense should be set at test-year levels.¹⁸⁸ Ms. Cannady, however disputed the test-year level of base labor expense for SSU. Ms. Cannady testified that the base-labor expense for shared services should be less than the test-year levels asserted by the company. She recommended a base-labor expense for shared services of \$27,881,058.¹⁸⁹ Ms. Cannady stated that the amount is “derived on Schedule CTC-5, and is based on the Company’s Schedule F-5.2, excluding payroll from cost centers that show no payroll allocation to APT.”¹⁹⁰ Schedule F-5.2 is Shared Services “SSU” Adjusted Total Labor Allocated to Pipeline for Payroll Tax Calculation.

Applicant’s Response

Ms. Myers testified on behalf of Atmos Pipeline-Texas and argued that the proposed adjustment should be rejected for several reasons. She noted that Ms. Cannady has

¹⁸⁸ ACSC Ex. 2, Direct Testimony of Constance T. Cannady, p. 11, lns. 13 – 15.

¹⁸⁹ *Id.* at ln. 19, Schedule CTC – 4.

¹⁹⁰ *Id.* At lns. 19 – 21.

inconsistently applied her proposed adjustment. She also noted that the data upon which Ms. Cannady based her proposed adjustment was flawed. Ms. Cannady based her proposed adjustment on an examination of Schedule F-5.2, "Shared Services ("SSU") Adjusted Total Labor Allocated to Pipeline for Payroll Tax Calculation." That schedule included base labor and all labor component including overtime, relocations, etc.). The figure included in company's base labor cost analysis did not include all labor expenses.

Examiners' Recommendation

The Examiners find that the base-labor expense for shared services should be set at the test-year level. Ms. Cannady's use of Schedule F-5.2 is mistaken for several reasons. First, the figure is intended to determine the Payroll Tax Calculation. Thus, it includes **all** labor expenses for each shared services unit cost center: base labor, overtime, relocation, etc.¹⁹¹ Second, Schedule F-5.2 does not include any labor expenses associated with Blueflame Insurance – so those expenses would not be captured in the calculations of Ms. Cannady. Fourth, Ms. Cannady raised no allegation that the test-year base labor expense for shared services provided by the company was inaccurate. Those figures were included in the supporting schedule provided by the company, and clearly identified in the electronic submissions of the utility. Fifth, the credibility of the proposal is undermined because it was inconsistently applied in the direct testimony filed by Ms. Cannady.¹⁹²

(C) Base Labor Level of Base Labor for SSU: Additional Adjustment

Ms. Cannady appeared to suggest that another change should be made to the base labor calculation. Essentially, this is also based upon an adjustment to the SSU allocated base labor, Ms. Cannady proposed an adjustment in the amount of \$182,646.¹⁹³ This appears to duplicate the adjustment discussed above and the Examiners do not find that the proposed adjustment is just and reasonable. Even if an adjustment is made to base labor, however, as suggested by Ms. Cannady, the Examiners recommend that this adjustment be rejected as it duplicates that proposed adjustment. In other words, if the base payroll expense is reduced to \$27,881,058, no further adjustment is justified because the two adjustments attempt to capture the same issue.

(D) Base Labor – Annualize Based Labor as of March, 2010.

Issue Raised by the Intervenor

The test-year in this proceeding is the twelve-month period ended March 31, 2010. As noted above the company adjusted the test-year figure. The utility examined base payroll expenses for the single month of March, 2010 and adjusted this expense category based upon expenses as of that month. ACSC maintained that any adjustment for annualized level of base labor should be rejected. Ms. Cannady testified that when she reviewed the base payroll expense she already noted significant increases during the course of the test year. Thus, any additional increase based upon a March 2010 annualized figure was not reasonable.

¹⁹¹ Atmos Ex. 18, Rebuttal Testimony of Barbara W. Myers, p. 15, lns. 2 – 4.

¹⁹² Atmos Ex. 18, Rebuttal Testimony of Barbara W. Myers, p. 14, lns. 21 – 22.

¹⁹³ ACSC Ex. 2, Direct Testimony of Constance T. Cannady, p. 13, ln. 17 – p. 14, ln. p.5.

In order to arrive at her conclusion, Ms. Cannady examined base payroll expense for Atmos Pipeline – Texas, Atmos Mid – Tex and Shared Services. Her analysis of Atmos Pipeline – Texas focused upon the test year. She noted that on average the total base payroll increased by 4.34% from March 2009 to March 2010. Thus, no adjustment should be made for base payroll expense at March of 2010 for Atmos Pipeline – Texas. Her analysis of Shared Services base payroll expenses and Atmos Mid – Tex employees focused upon historic increases in those expenses that she observed from December 2008 and December 2009. Presumably, although not explicitly stated in her testimony, the increasing trend continued throughout the test year and for that reason no adjustment should be made. She also alleged that the test year base payroll expense for appropriately allocated costs from SSU was significantly lower than the annualized figure alleged by the company. Accordingly, no adjustment should be made.

Applicant's Response

Ms. Myers responded by stating that it is reasonable to adjust test-year base payroll figures based upon the base payroll expenses for March 31, 2010. First, March 31, 2010, is within the test year and it is a known amount. Second, she explained that the reason test-year figures are annualized is for the purpose of setting a payroll expense that reflects the level of employees and their respective base pay as of the end of the test year. A point that Ms. Myers noted was underscored by ACSC's own witness. She concluded that use of the company's annualized payroll expense at the end of the test year is the most accurate way to capture base labor costs.¹⁹⁴

Examiners' Recommendation

The Examiners recommend that rates established be based upon the test-year expenses for base labor and that no adjustment be made to either increase or reduce the test-year figures. As observed by Ms. Cannady, the increasing trend of test-year expenses for Atmos Pipeline – Texas is accurately captured in the test-year data. No further adjustment should be required. Rates are typically based upon test-year data and this Commission has previously established base payroll expenses based on test-year figures.¹⁹⁵

(E) Base Labor - Allocation of Base Labor Adjustment

The company proposed that any base labor adjustments be allocated to Atmos Pipeline – Texas based upon the following percentages. SSU base labor adjustment should be allocated based upon 14.30%; Mid-Tex Employee should be allocated based upon 25.81%, and expenses for Atmos Pipeline-Texas should be allocated based upon 100%. Ms. Cannady contended that each of these allocations was incorrect.

As to SSU, Ms. Cannady recommended that it should be based upon what she alleged was the actual percentage of payroll allocated to Atmos Pipeline – Texas from SSU cost centers or 14.67%. As to Atmos Mid – Tex, she recommended a revision to the allocations based upon a 2009 RRM filing with the municipalities. Finally, with respect to Atmos Pipeline – Texas

¹⁹⁴ Atmos Ex. 18, Rebuttal Testimony of Barbara W. Myers, p. 13, Ins. 5 – 18.

¹⁹⁵ GUD No. 9902, Final Order, Finding of Fact No. 62.

rates she argued that charging 100% of any adjustment fails to take into account the fact that Atmos Pipeline-Texas actually charged other divisions \$947,150 in base payroll during the test year. In fact, she argued that an adjustment should be made to base payroll expenses to recognize this fact.

Ms. Cannady's proposed allocation factor of the SSU labor expense is inconsistent with the allocation factor proposed by the company for all SSU expenses and inconsistent with Ms. Cannady's proposed allocation factor. The Examiners find that it is simply inappropriate to create a special allocation factor for this single adjustment. The Examiners find, however, that the company's proposed adjustment fails to account for the fact that Atmos Pipeline – Texas provides services to the other operating division. During the test year direct base labor was \$5,442,443.61. Of that amount \$947,149.93 was cross charged to other divisions, or approximately 17.40%. Thus, approximately 82.60% of Atmos Pipeline – Texas direct labor expense was not charged to other divisions.¹⁹⁶ Accordingly, it is appropriate to limit the proposed Atmos Pipeline – Texas base labor adjustment to 82.60% of the proposed Atmos Pipeline – Texas base labor adjustment.

(F) Base Labor – O&M Expense Factor

In calculating its adjustment, the utility used the following O&M Expense factors. The SSU O&M Expense factor was 94.97%, the Atmos Mid-Tex O&M Expense factor was 69.27% and the Atmos Pipeline – Texas expense factor was 96.18%. Ms. Cannady presented a schedule that adjusted those factors as follows. The SSU O&M Expense factor was 71.50%, the Atmos Mid-Tex Expense factor was 50.05%, and the Atmos Pipeline-Texas expense factor was 96.18%. Ms. Cannady does not provide any testimony in support that change and the Examiners recommend that any proposed adjustment be rejected.

(G) Base Labor – Adjustment for ATP Labor Expenses Charged to Other Divisions.

Ms. Cannady argued that Atmos Pipeline – Texas actually charged other divisions \$947,150 in base payroll during the test year. In her opinion, this amount should not now be charged again to Atmos Pipeline – Texas rate payers. She argued that an adjustment should be made to reflect this fact. The Examiners find that there is no evidence to suggest that this amount, \$947,150 was included in base labor. Accordingly, an adjustment should not now be made to remove this figure. Furthermore, the adjustment noted in sub-section (E) above captures the fact that part of the proposed adjustment should be allocated to other divisions.

(H) Base Labor – Merit Increases

The company's base payroll adjustment included an amount for merit increases that were approved prior to the filing of this case and awarded to employees after the case was filed. Ms. Cannady, on behalf of ACSC, and Jacob Pous, on behalf of the City of Dallas objected to this adjustment to the labor expense. Ms. Cannady argued that the merit increase was effective

¹⁹⁶ See, Rate Filing Package, Relied Files, Base Labor Report – Pipeline – 12 Months ended March 2010 and ACSC Ex. 2, p. 14.

until long after the end of the test year ended March 31, 2010.¹⁹⁷ Mr. Pous contended that the company is overpaying employees. He argued that current economic conditions make a merit increase inappropriate as the economy contracts and government agencies are contracting its labor force.

Ms. Myers who testified on behalf of Atmos Pipeline – Texas noted that the company's proposal is consistent with prior proceedings. She explained that the Commission has previously considered arguments similar to those raised by the Intervenors and rejected them. She asserted that no party has challenged the reasonableness of the company's staffing levels or its need to attract and retain qualified personnel.¹⁹⁸

The Examiners find that the company has established the proposed expenses related to merit increases is just and reasonable. First, it is a known and measurable change. Second, it has been implemented. Third, the arguments raised by the Intervenors have been previously rejected by the Commission in GUD Nos. 9762, 9869, and 9902.

(I) Medical and Dental Expenses

Medical and Dental Benefit expenses during the test year were \$27,204,891. The allocated portion of that was \$5,001,105.44.¹⁹⁹ The company pays for 80% of all medical costs related to employees and eligible employee dependents. ACSC argued that the pre-allocated test-year amount was unreasonable.

Ms. Cannady contended that the pre-allocated test-year amount should not exceed \$13,602,446. She arrived at that figure by reducing medical and dental benefit costs per employee for SSU, Atmos Mid – Tex, and Atmos Pipeline – Texas by 50%. Ms. Cannady asserted that the company's practice of paying medical and dental expenses of eligible dependents was unreasonable and argued that the shareholders should pay for this added benefit. ACSC argued that the evidence in the record revealed that the company spent \$9,600 and \$10,126 per employee, every year, or about \$805 per month.²⁰⁰ ACSC concluded that this was a level of expense for employee benefits above and beyond industry standards and to the extent the company desires to provide benefits beyond industry standards, shareholder should pay those expenses.

The Examiners find that Atmos Pipeline – Texas has established that the level of medical and dental benefits provided to its employees is just and reasonable. As noted at the hearing, the data relied upon to arrive at the calculation ACSC asserted was inaccurate. The calculation is not based on the actual number of employees that fluctuates on a monthly basis. Additionally, except for the unsubstantiated statements of Ms. Cannady, no evidence was provided that the level of expense incurred by Atmos Pipeline – Texas was above industry standard. The proposed adjustment is premised on a reduction in excess of the thirteen million dollars to the company's test-year figures for medical and dental benefits. The Examiners find

¹⁹⁷ ACSC Ex. 2, p. 10, ln. 17 – p. 11, ln. 10.

¹⁹⁸ Atmos Ex. 19, Rebuttal Testimony of Barbara W. Myers, pp. 7 – 17.

¹⁹⁹ Atmos Ex. 3, Errata No. 2, Schedule F – 2.2. $[(\$10,601,412 \times 2.56\%) + (\$16,004,542 \times 25.81\%) + (\$598,937)] = \$5,001,105$

²⁰⁰ ACSC Initial Brief, p. 24.

that at least some evidence should be provided before such a draconian cut in medical and dental expenses is made to the company's calculation. Ms. Myers provided testimony that the benefits package provided by the company is consistent with industry standards and consistent with the Patient Protection and Affordable Care Act.

(J) Overtime Expense

The company included \$2,020,974 related to direct overtime expense in the cost of service. Mr. Pous, on behalf of the City of Dallas, contended that the overtime levels fluctuate significantly over time. In calendar year 2007, the level overtime was \$1.3 million while in calendar year 2009 it was \$2.2 million. The overtime expense, however, declined between calendar year 2009 and the test year.²⁰¹

Ms. Myers responded by noting that the Commission has previously considered the same argument and rejected it in GUD No. 9869. She noted that the prudence of the expense is not challenged, that Mr. Pous has not demonstrated that the proposed three-year average is reflective of the company's current or future projected overtime expense. Furthermore, she noted that the trend revealed by the data evaluated by Mr. Pous has been steadily increasing since 2007.²⁰²

The Examiners find that the company's requested expense for direct overtime is just and reasonable. The utility has established that the proposed expense of \$2,020,974 is reasonable. Table 10.2 sets out the direct overtime expense levels for Atmos Pipeline – Texas:

Table 10.2²⁰³

	2007	2008	2009
Overtime Expense	\$1,285,160	\$2,099,747	\$2,230,956
Change		\$814,587	\$131,209
Percentage Change from prior year		63%	6.2%
Percentage difference from Dallas Proposal	45%	-12%	-16%

The test-year amount is far below the 2008 amount and is lower than the amount in 2007. The proposed test-year level is lower than the direct overtime expense experienced by Atmos Pipeline – Texas in either 2008 or 2009. And it is lower than the test-year level for the twelve month period ended March 31, 2010. There is no basis to conclude that a level of overtime expense for Atmos Pipeline – Texas of \$1,871,948 is just and reasonable. It is in excess of 12% less than the level of expense experienced by the company in the last two years and nearly 11% less than the level experienced during the test year.

²⁰¹ City of Dallas, Ex. 1, Direct Testimony of Jacob Pous, p. 86, ln. 9 – p. 87, ln. 18.

²⁰² Atmos Ex. 18, Rebuttal Testimony of Barbara W. Myers, p. 18, ln. 1 – p. 19, ln. 7.

²⁰³ Atmos Ex. 18, Rebuttal Testimony of Barbary W. Myers, Exhibit BWM-R-1.

(K) Incentive Compensation

Atmos Pipeline – Texas has three incentive compensation programs: (1) Variable Pay Plan (VPP), (2) Management Incentive Plan (MIP), and (3) Long Term Incentive Plan (LTIP). The LTIP is sometimes referred to as the restricted stock plan. These three plans apply to SSU employees and Atmos Pipeline – Texas employees. In prior proceedings, the Commission has disallowed expenses associated with SSU employees from calculation of the cost of service. On the other hand, expenses associated with those plans have previously been included for direct division employees. The prior Commission handling of the expenses associated with these three programs is set out in Table 10.3.

Table 10.3
Commission Treatment of Incentive Compensation for Atmos Energy Corp.

	Direct Divisions, i.e. Atmos Mid – Tex	Shared Services Unit
VPP	Commission has included in cost of service calculation	Commission has excluded in cost of service calculation
MIP		
LTIP	Commission has included	Commission has included

ACSC, ATM, and the City of Dallas all provided testimony and argued that all costs associated with the incentive compensation programs should be removed from the cost of service. They contended that the focus of the incentive plans is on the corporate-wide financial results of the Atmos Energy Corporation, including regulated entities located in other states and non-regulated entities.²⁰⁴ The targets encompassed in these plans are not directly linked to customer service, employee safety, cost reductions, individual employee performance, or operational achievements or efficiencies in the areas served by Atmos Pipeline – Texas. Unlike merit increases, the incentive compensation may not be awarded. Carver contended that the party who benefits from the incentive compensation should shoulder the burden. And in his opinion shareholders reap the benefits.

Richard Erskine, Jeffrey S. Knights, and Barbara Myers offered testimony on behalf Atmos Pipeline – Texas related to incentive compensation. Mr. Knights noted that while financial performance may be used to determine the level of incentive compensation available, the overall employee performance is utilized to determine if individual employees are eligible to receive incentive compensation. Employee performance includes elements such as safety, customer service, system operations and adherence to company policy and practices. He contended that safety and customer service are key drivers in meeting any financial target. Mr. Erskine and Ms. Myers argued that a decision to remove incentive compensation in this proceeding would result in inconsistent treatment of the same expense between Atmos Mid – Tex and Atmos Pipeline – Texas.

The Examiners find that as to incentive compensation there is overall agreement on two facts. First, Atmos Pipeline – Texas has treated incentive compensation consistent with the

²⁰⁴ City of Dallas Ex. 1, Direct Testimony of Jacob Pous, p. 78, ln. 19 – p. 81, ln. 6, ACSC Ex. 2, Direct Testimony of Constance T. Cannady, p. 19, ln. 1, - p. 24, ln. 2, ATM Ex. 1, Direct Testimony of Steven Carver, p. 34, ln. 5 – p. 46, ln. 18.

prior proceedings involving other division of Atmos Energy Corporation, i.e. Atmos Mid – Tex. None of the Intervenor contend that this is not true.²⁰⁵ Second, Atmos Pipeline – Texas does not dispute that there is no distinction in the metrics of the incentive compensation program applied to SSU employees and Atmos Pipeline – Texas direct employees. Beyond these two points there is little agreement among the parties.

Although Atmos Pipeline – Texas did not include expenses associated with VPP, MIP, and LTIP in its rate request, it is the company's position that these expenses are fully recoverable. The only reason they were not included was to remain consistent with the prior determination of the Commission. The Intervenor contend that there is no distinction between SSU employees and Atmos Pipeline – Texas employees and, therefore, this category of expense should be excluded from cost of service for both SSU employees and Atmos Pipeline – Texas.

The Examiners find that Atmos Pipeline – Texas, through the testimony filed by Mr. Knights and Mr. Erskine, has established that customers may derive a benefit from these programs. On the other hand, the Examiners find that the Intervenor have established that shareholders also derive a benefit from these programs as well. Including all of the incentive compensation program expenses in rates is not reasonable as the ratepayer would be required to shoulder the entire burden of a program that clearly provides a benefit to shareholders and is focused, to a large degree, on shareholder returns. The Commission's prior decisions reflect a reasonable balance.

Insufficient evidence has been provided to deviate from the Commission's prior determinations on this issue. While the programs may be the same for SSU employees and Atmos Pipeline – Texas employees, there is no evidence to show that this is different from the circumstances in the prior proceedings. The distinction provided in those prior decisions appears reasonable. It allows the recovery through rates of incentive compensation for employees who are direct employees of the division and requires shareholders to bear the burden of incentive compensation for employees that provide services to another division other than the one to which they are directly assigned. Additionally, the recovery of the incentive compensation costs is allowed for employees who interface with customers on behalf of their division and it requires shareholders to shoulder the burden of expenses for incentive compensation for employees who provide services to other divisions. This appears to reasonably balance the burden of these expenses among all who may benefit from the incentive compensation program.

(L) Pension Account Plan

The company has included Pension and Retiree Medical Benefit Expenses in the cost of service calculation. The inclusion of an amount for Pension and Retiree Medical Benefit Expenses does not appear to be disputed. The test-year amount for this expense category was

²⁰⁵ While the language in Finding of Fact No. 69 contained in the Final Order issued in GUD No. 9869 is broad, the fact of the matter is, that the Commission's decision in that case allowed the recovery in rates of incentive compensation for Atmos Mid – Tex direct employees. Thus, the language contained in Finding of Fact No. 69 must be balanced with the overall determination of the Commission in that case. That determination was consistent with prior decisions and as discussed above reasonably balanced the expense of these programs.

\$8,678,736.²⁰⁶ The dispute in this issue centers on a \$79,276 adjustment to the test-year figures proposed by the company. The adjustment was calculated by comparing the fiscal year 2010 actuarial data to the test-year amount and adjusting to the actuarial data. The actuarial data was prepared by Towers Watson. The company asserted that the Pension Account Plan has been previously approved in GUD Nos. 9762 and 9869 and the company applied the same known and measurable adjustment, based on actuarial studies, that was approved by the Commission in those dockets.²⁰⁷

Ms. Cannady, on behalf of ACSC, noted the Towers Watson report that formed the basis of utility's adjustment. Ms. Cannady recommended that the company not be allowed to recover any expense greater than the test-year expense. She asserted that the proposed increase is based entirely on the fact that the returns of the plan were lower than expected. She argued that the ratepayers should not now be required to make up the difference because the ratepayers have no input into the manner in which the company invests the contribution originally made by ratepayers. She contended that investing funds provided by ratepayers and then losing those funds does not entitle the company to come back to the ratepayers to make up the difference. Shareholders should bear the responsibility to manage the funds in such a manner that does not require continually seeking recovery of market losses from ratepayers.²⁰⁸

In response, Ms. Myers stated that the pension expense was influenced by four factors: First, the return on the fair value of the plan assets since the prior measurement date was less than expected. Second, the market-related value of plan assets decreased the pension cost. Third, contributions to the plan during the prior year decreased the pension cost and improved the funded position. Fourth, the discount rate decreased 205 basis points compared to the prior year. Ms. Myers also noted that the company's plan is comparable to pension and retirement plans offered by similar utilities. Finally, she noted that Atmos Pipeline – Texas applied the same known and measurable adjustment in GUD Nos. 9762 and 9869.²⁰⁹ Ms. Myers also noted that the shareholders do not benefit from the plan or its assets. Finally, she noted that the adjustment is one sided. In other words, she noted that the Intervenor do not propose to provide a credit to the company in the event that there is a reduction in costs.²¹⁰

The Examiners find that the company has established that the adjustment to the test-year level of expenses for the pension account plan is reasonable. The Intervenor correctly noted that the ratepayer has no control over the management of the funds that ratepayers have provided to fund this plan. There is no evidence, however, that the funds were inappropriately managed.

(M) Supplemental Executive Benefit Plan

Atmos Energy Corporation and its divisions offer a supplemental executive benefits plan.²¹¹ The plan provides additional pension, disability and death benefits to officers, division

²⁰⁶ Atmos Ex. 3, Errata No. 2, Schedule F-2.3, ln. 2 (\$3,275,308 + \$5,080,993 + \$322,435 = \$8,678,736).

²⁰⁷ Atmos Ex. 18, Rebuttal Testimony of Barbara Myers, p. 23, lns. 12 – 19.

²⁰⁸ ACSC Ex. 2, Direct Testimony of Constance T. Cannady, p. 16, ln. 6 – p. 17, ln. 4.

²⁰⁹ Atmos Ex. 18, Direct Testimony of Barbara Myers, p. 21, ln. 13 – p. 22, ln. 11.

²¹⁰ Atmos Ex. 18, Direct Testimony of Barbara Myers, p. 24, lns. 1 – 16.

²¹¹ The evidence in the record established that the SEBP may also be referenced as the Supplemental Executive Retirement Plan ("SERP"). There are three separate plans: A Supplemental Executive Benefit Plan for eligible employees on or before

president and certain other employees of the company.²¹² The company has not included any SEBP costs related to employees of SSU. Atmos Pipeline – Texas included approximately \$340,000 for this expense category in the cost of service calculation for direct employees of Atmos Pipeline – Texas. ACSC, ATM and the City of Dallas argued that the entire amount should be disallowed.

Mr. Carver, on behalf of ATM, noted that there is no difference between the SEBP offered to SSU employees and SEBP offered to direct employees of Atmos Pipeline – Texas. As the costs of SEBP for SSU and Atmos Pipeline – Texas are derived from the very same plan documents, the SEBP costs for Atmos Pipeline – Texas should also be disallowed.²¹³ Mr. Pous, on behalf of the City of Dallas, echoed the same argument: consistency requires exclusion from the SSU and Atmos Pipeline – Texas.²¹⁴ Ms. Cannady, on behalf of ACSC, contended that these benefits are established for highly paid management to supplement pension and retirement benefits afforded to all employees. She asserted that shareholder, not ratepayers, should be responsible for funding additional benefits above those reasonably provided and made available to all employees.²¹⁵

Atmos Pipeline – Texas contended that all costs associated with SEBP are just and reasonable. The company has, however, not included SEBP costs associated with SSU employees in recognition of the Commission's prior determination. Ms. Myers noted that in GUD No. 9869, the Commission evaluated, considered, and drew a distinction between direct versions allocated SEBP/SERP costs for purposes of including these expenses in the utility's cost of service. The Commission found that the inclusion of direct SEBP/SERP expense was reasonable and necessary to the provision of utility service and included these expenses in the cost of service calculation.²¹⁶

The Examiners find that Atmos Pipeline – Texas has established that expenses included in this proceeding for SEBP are just and reasonable. The company established that these costs are attributable to all executive or management employees who have entered into noncompete agreements and who have been designated by the Board of Directors. The Examiners find that the Commission, by disallowing the expense for SSU employees and allowing the expense for the direct employees, has balanced the burden of this expense between ratepayers and shareholders. As with incentive compensation, discussed above, both shareholders and ratepayers enjoy a benefit from this expense.

August 12, 1998; a Supplemental Executive Retirement Plan (formerly known as the Performance-Based Supplemental Executive Benefit Plan) for eligible employees after August 12, 1998; and a new SERP effective August 4, 2009. See, ATM Exhibit 1, Direct Testimony of Steven Carver, p. 47, fn. 36.

²¹² ACSC Ex. 2, Direct Testimony of Constance T. Cannady, p. 18, lns. 4 – 10.

²¹³ ACSC Exhibit 1, Direct Testimony of Steven Carver, p. 47, ln. 1 – p. 52, ln. 6.

²¹⁴ City of Dallas Ex. 1., Direct Testimony of Jacob Pous, p. 89, ln. 25 – p. 91, ln. 10.

²¹⁵ ACSC Ex. 2, Direct Testimony of Constance T. Cannady, p. 17, ln. 15 – p. 18, ln. 22.

²¹⁶ Atmos Ex. 18, Rebuttal Testimony of Barbara W. Myers, p. 25, ln. 8 – p. 26, ln. 10.

(N) Cost Center 1905 – Outside Director Retirement Cost

Cost Center 1905 is a Shared Services Unit cost center and represents expenses associated with the cost of non-employee members of the board of directors.²¹⁷ Based upon the evidence in the record, in GUD No. 9670, the Commission disallowed this expense item. In GUD No. 9762, however, the Commission determined, based upon the evidence in the record regarding the function of that cost center that the amounts included for Cost Center 1905 were just and reasonable. In this proceeding, the company indicated that the expenses for Cost Center 1905 were \$1,559,364. Of that amount, \$246,847 are proposed to be allocated to Atmos Texas – Pipeline. ACSC and the City of Dallas contended that the Commission should reverse its prior determination and exclude these amounts.

Ms. Cannady contended that the Commission correctly determined in GUD No. 9670 that those expenses should be excluded. In the GUD No. 9670, however, Mr. Cannady contended that the Commission erred by reversing the Examiners' recommendation, and including those expenses in the cost of service. She argued that while it is true that publicly traded companies have board of directors, the board of directors are directly responsible to shareholders not ratepayers. Accordingly, these expenses should be disallowed.²¹⁸

Mr. Pous noted that the compensation recorded in this cost center is based on the number of shares granted and the grant date fair value of the stock awarded. He argued that Cost Center 1502, Shared Services Dallas Corporate Secretary, books amounts for fees and other costs of the Board of Directors. He contended, therefore, that the customers are providing compensation for the board members and that Cost Center 1905 is the equivalent of incremental incentive compensation. As incentive compensation has been removed for SSU in GUD No. 9869 it should not be included here.²¹⁹

Ms. Myers pointed out that the Commission directly considered this issue as it deliberated the Final Order in GUD No. 9762. Furthermore, she noted that the Commission approved this expense in GUD No. 9869. Ms. Myers reiterated the evidence considered by the Commission in GUD Nos. 9762 and 9869. As a publicly traded company, Atmos is required to establish a Board of Directors and must compensate those directors. The company's status as a publicly traded company enables it to have access to the capital markets to obtain cost-effective capital. This fact benefits customers because it ensures that capital resources are available to fund the necessary investment that must be made to ensure the safe and reliable provision of utility service. Furthermore, the Board of Directors is responsible for making decisions that impact the company. In response to the contentions raised by Mr. Pous, Ms. Myers argued that the costs recorded in Cost Center 1905 relate to the annual grant of share units to non-employee directors for their service on the board and it is not incentive compensation.²²⁰

The Examiners find that the company has established that costs associated with Cost Center 1905 are just and reasonable. The expense is a necessary expense of publicly traded companies – a fact determined by the Commission in GUD No. 9762 and affirmed in GUD No.

²¹⁷ See, GUD No. 9670, Proposal for Decision, p. 49; GUD No. 9762, Proposal for Decision, pp. 46 - 47

²¹⁸ ACSC Ex. 2, Direct Testimony of Constance T. Cannady, p. 22, ln. 21 – p. 24, ln. 2.

²¹⁹ City of Dallas, Ex. 2, p. 87, ln. 20 – p. 89, ln. 25.

²²⁰ Atmos Ex. 18, Rebuttal Testimony of Barbara W. Myers, p. 32, ln. 10 – p. 36, ln. 8.

9869. The Examiners find that the compensation provided is not incentive compensation. Instead, it represents compensation to the non-employee members for their service on the board.

b. Kinder Morgan Treating Fees

The company included an adjustment to the cost of service in the amount of \$1,284,074, to reflect an annual ongoing expense for operating fees related to the treater agreement with Kinder Morgan. The adjustment made by the company related to the blending and treating revenues for the test year. ACSC argued that this expense adjustment should be removed because it does not take into account the revenues that will be recovered by Atmos Pipeline – Texas for this service. This case was filed on September 22, 2010, and the company's calculations did not include an adjustment to other revenues to reflect revenues from blending and treating.²²¹ The company filed errata to the schedules on November 22, 2010. Ms. Myers testified that the errata filing included an adjustment to reflect revenues from blending and treating.²²² An examination of that filing establishes that the company included an adjustment for other revenues from blending and treating.²²³ The Examiners find that this issue raised by ACSC has been addressed by the company. ACSC contended in briefing that the company should have differentiated between treating and blending and consequently an adjustment still must be made. Expenses and revenues for each should have been tracked separately in the filing. There is no evidence in the record that these have not been correctly traced by the company. Accordingly, the Examiners do not recommend an additional adjustment to the company's request.

c. Depreciation Expense

The company proposed new depreciation rates for assets in Atmos Pipeline – Texas and SSU based on a depreciation study sponsored by Mr. Dane Watson.²²⁴ The SSU depreciation rates were examined and approved by the Commission in GUD Nos. 9762 and 9869 and are not contested in this case. The result of the company's calculation is an increase to Atmos Pipeline – Texas direct depreciation expense of approximately \$5.8 million and a decrease to SSU depreciation expense allocated to Atmos Pipeline – Texas of approximately \$48,000. The City of Dallas challenged the depreciation expense proposal of Atmos Pipeline – Texas.

(A) Service Life Parameters

The City of Dallas challenged the average service life calculations of five accounts:

- Account 352 (Underground Storage Wells and Reservoirs)
- Account 354 (Underground Storage Compressor Equipment)
- Account 367 (Transmission Mains)
- Account 368 (Transmission Compressor Stations)
- Account 369 (Transmission Measuring and Regulating Equipment)

²²¹ Atmos Ex. 2, Other Revenue Credit Adjustment.

²²² Atmos Ex. 18, Rebuttal Testimony of Barbara W. Myers, p. 37, Ins. 12 – 19.

²²³ Atmos Ex. 3, Errata Other Revenue Credit Adjustment, Excel Lns. 49 – 61.

²²⁴ Atmos Ex. 13, Direct Testimony of Dane Watson, p. 14.

The City of Dallas raised several general issues with regard to the analysis of each account. First, the City of Dallas contended that the analysis was based only upon general guidelines. Second, the City of Dallas faults Mr. Watson's lack of involvement in the analysis. Third, the City of Dallas contended that Mr. Watson did not rely on mathematical curve-fitting analysis and instead limited himself to a visual inspection of the data. As to Account 352, the City of Dallas contended that a service life of 52 years was not reasonable given the longevity to be expected of those assets. As to Account 354, too much emphasis was placed on the expectation that new high speed compressors will have shorter lives; it is too early to make that adjustment without supporting empirical data. As to Account 367, the company does not take into account that newer pipe is expected to last longer. As to Account 369, Mr. Watson relied on a placement band developed using a 1962 to 2009 historical range; whereas a placement band from 1995 to 2009 is more appropriate. Finally, as to Account 369, the company recommendation is based upon a placement band with an historical range that begins in 1900 and is simply not a reasonable basis upon which to determine the service life for this account.

The company responded by noting that the City of Dallas ignores other factors that were used to evaluate the service life. The service life recommendations of Mr. Watson were guided by account history and interviews with company personnel. In each case, the account history and data from interviews with personnel confirmed the reasonableness of Mr. Watson's average service life conclusions.

The Examiners find that Atmos Pipeline – Texas has established that the average service life recommendations for each of these accounts are just and reasonable. Mr. Watson provided all relevant information upon which his analysis was based, and confirmed his analysis by an examination of the individual accounts on a case-by-case basis and through interviews with company personnel.

(B) Net Salvage

Net salvage is the difference between the gross salvage (what is received in scrap value for the asset when retired) and the removal cost (cost to remove and dispose of the asset). The company asserted that the method Mr. Watson applied was the same methodology that was approved in the last fully litigated case before the Commission in GUD No. 9400 and it is consistent with industry standards.

The City of Dallas contended that the net salvage for the following accounts were not correctly calculated: Account 352 (underground storage wells) and Account 367 (transmission mains). An overall problem with the company's analyses articulated by the City of Dallas is that the company's analysis was unreasonably limited to a narrow historical period from 2005 through 2009. Many of the accounts experienced no retirements during this limited period and no consistent patterns could emerge in such a narrow timeframe. The City of Dallas concluded that this limited historical period is simply an insufficient basis for a \$119 million increase over existing depreciation rates. Two accounts responsible for \$100 million dollars of that increase and the City of Dallas specifically challenged the depreciation rates of those two accounts.

(a) Account 352 – Underground Storage Wells and Reservoir

The company proposed a change from the existing zero level of net salvage to a negative (10%) for Account 352. The City of Dallas recommended a positive 20% net salvage for this account. Account 352 is for underground storage well and reservoirs and the value of a storage reservoir alleged by Mr. Pous is expected to be significant after 50 years of use. Mr. Pous contended that the company's limited database and analysis, however, unreasonably focused on one event in the limited historical period analyzed. It involved a minor dollar level of retirement in comparison to the outstanding balance, and failed to take into account the significant value that could be obtained if the reservoir was sold.

Atmos Pipeline – Texas responded by noting that Mr. Pous discounted the company's data and provided no evidence, aside from speculation, that the reservoirs booked in this account hold potential value upon their retirement. In response to the allegations regarding the overall historic time period, Mr. Watson noted that he has provided decades of net salvage data presented on a function basis that were used in GUD Nos. 8976 and 9400 to set depreciation rates in those cases.²²⁵ Mr. Watson noted that the sale of the Pecan Storage facility prior to the end of its useful life produced a net salvage of only 5.70%. Additionally, the company notes that evidence provided by the company indicates that the net salvage experienced by other gas utilities across the nation for this account from 1997 through 1998 is a negative 9.60%.²²⁶

The Examiners find that Atmos Pipeline – Texas has established that the proposed depreciation expense of Account 352 is just and reasonable. Although the historical parameter used by Mr. Watson is rather narrow it does not stand in isolation. There is other data that supports his conclusion such as the functional data included in the documents relied upon by Mr. Watson. The City of Dallas did not indicate that there was any evidence in that data that contradicted Mr. Watson's conclusions. Furthermore, although somewhat dated, the historical experience of other utilities from 1997 through 1998 supports the company's conclusions regarding Account 352. Finally, the net salvage of the Pecan Storage facility was significantly less than the positive 20% proposed by the City of Dallas.

(b) Account 367 – Transmission Main

The company proposed a negative net salvage of 15% for Account 367. The City of Dallas contended that this was inappropriate and that an appropriate net salvage was 5% for this account. The City of Dallas argued that the historical basis was insufficient upon which to base its request and the request represented three times the average level of annual cost experienced during the time frame analyzed. Further, Mr. Pous challenged the content of the data: (1) the company did not include a \$5,800 positive net salvage value relating to removal of 1,200 linear feet of 18-inch pipe in one retirement project; (2) the data included a large sampling with a disproportionate level of costs associated with the removal of asbestos-laden mill-wrapped pipe; (3) the data included a small proportion of the company's larger diameter pipe which is cheaper to remove than smaller diameter pipe. As a result, Mr. Pous recommended a net salvage of 5% for this account.

²²⁵ Atmos Ex. 23, Rebuttal Testimony of Dane A. Watson, p. 55, Ins. 7 – 9.

²²⁶ Atmos Ex. 23, Rebuttal Testimony of Dane A. Watson, p. 62, Ins. 3 – 17.

Mr. Watson responded by arguing that the City of Dallas simply ignored the data which established that a negative net salvage of 15% was just and reasonable. As to the omission of the \$5,800 in gross salvage from one removal project, Mr. Watson notes that it is insignificant when compared to the company's annual retirement costs that can reach between \$9 and \$11 million. Mr. Watson argued that the content of the data used to evaluate net salvage was appropriate.

The Examiners find that Atmos Pipeline – Texas has established that the net salvage calculation for Account 367 is just and reasonable. The data relied upon clearly established a trend over the last five years that supports a net salvage of negative 15%. Again, the net salvage level experienced by other utilities between 1997 and 1998 of a negative 13.50%, while not determinative in this case, supports the company's conclusion. Finally, the Examiners find that there is no evidence in the record that would support a negative net salvage calculation of negative 5%.

d. Affiliate Expenses

GURA requires that affiliate expenses meet the following two criteria: (1) that they are reasonable and necessary, and (2) that the price charged to the gas utility be no higher than the prices charged by the supplying affiliate to its other affiliates or divisions, or to a non-affiliated person for the same item or class of items.²²⁷

Included in the cost of service in this case is the cost allocated to Atmos Pipeline – Texas for insurance by Blueflame Insurance Services, Ltd. (Blueflame). Robert J. Smith, who testified on behalf of Atmos Pipeline – Texas provided testimony on the services Blueflame provides and costs to Atmos Pipeline – Texas. Blueflame was chartered in Bermuda effective December 2003 and was operational in January 2004.²²⁸ Blueflame is a wholly-owned subsidiary of Atmos Energy Corporation (Atmos). The insurance services provided by Blueflame are at cost and with no markup.²²⁹ Additionally, Blueflame does not provide service to any entity other than Atmos and its affiliates.²³⁰ Blueflame is managed by Aon Risk Managers – Bermuda on a day-to-day basis.²³¹ Aon is one of the largest third party risk management consulting firms in the world.²³²

Mr. Smith further testifies in his direct testimony that Blueflame exists solely to allow Atmos to gain entrance to the reinsurance market in order to obtain greater and more cost effective insurance coverage than would otherwise be available to Atmos.²³³ All of Atmos Pipeline – Texas property, plant, and equipment are covered through property insurance provided by Blueflame.²³⁴ The administrative fees and cost of reinsurance premiums are costs paid by Blueflame directly to non-affiliated third parties and are then charged back to Atmos by

²²⁷ Tex. Utils. Code Ann. § 104.055.

²²⁸ Atmos Ex. 9, p. 9, lns. 16-17.

²²⁹ *Id* at lns. 20-21.

²³⁰ *Id* at lns. 21-22.

²³¹ *Id* at p. 10, lns. 1-4.

²³² *Id* at lns. 4-5.

²³³ *Id* at lns. 18-21.

²³⁴ *Id* at p. 11, lns. 3-4.

Blueflame with no markup.²³⁵ Because each division and subsidiary of Atmos' annual plant balance is the basis for apportioning the property insurance costs, everyone pays the same rate. In this case it is \$0.085 per \$100 of gross plant.²³⁶

According to Mr. Smith, the Commission has reviewed the Blueflame program in GUD Nos. 9670, 9762 and 9869, all Atmos Mid – Tex division rate cases.²³⁷ The Commission found in each of those cases that the services provided by Blueflame to Atmos Mid – Tex was reasonable and necessary.²³⁸ The Commission also found that the price paid by Atmos Mid – Tex for these services was not higher than the price charged by Blueflame to other Atmos affiliates or division.²³⁹

Michael L. Brosch filed direct testimony on behalf of ATM challenging the charge by Blueflame as unreasonable and excessive.²⁴⁰ Mr. Brosch states that only a portion of the premium Atmos Pipeline – Texas calls at cost is at cost. The "Property Damage Deductible Reimbursement" coverage is provided directly by Blueflame and there is no measurable "cost" basis.²⁴¹ Mr. Brosch provided the following breakdown of the Blueflame property insurance premium.²⁴²

Table 10.4

Premium Cost Element	Amount	Coverage Layer/Limit
Aegis Reinsurance Premium Cost	\$ 3,960,673	\$ 250 million over \$ 1 million deductible
Lloyds Operators/Terrorism Cost	93,840	\$ 20/2 million over \$55/200/100 deductible
BFI provided – deductible reimbursement	2,057,705	\$ 1 million, less \$100,000 per occurrence
Total BFI Premium to Atmos (all Entities)	\$ 6,112,218	

ATM contends the \$2,057,705 annual premium in the shaded area above is excessive. ATM believes that the annual premium to extend only \$900,000 of deductible reimbursement coverage (1 million less the \$100,000) is unwarranted. Mr. Brosch contends the retained portion of premiums is excessive and unreasonable and Blueflame's loss experience and capital requirements do not justify such a large retained premium.²⁴³

ATM reasons that if Blueflame was providing service at "cost" then the retained premium, for which Blueflame invests for interest income, would not show income from interest. ATM contends Blueflame should report net income at zero, if the premium charged

²³⁵ *Id* at lns. 12-14.

²³⁶ *Id* at p. 12, lns. 4.

²³⁷ *Id* at p. 13, lns. 6-8.

²³⁸ *Id* at lns. 12-13.

²³⁹ *Id* at lns. 13-16.

²⁴⁰ ATM Ex. 2, p. 42, lns. 4-5.

²⁴¹ *Id* at lns. 22-25.

²⁴² *Id* at p. 43, Table 4.

²⁴³ *Id* at lns. 12-16.

were truly at cost.²⁴⁴ According to ATM's RFI 1-31, Blueflame reported Net Income of \$6,562,492 for the twelve months ended September 30, 2009 and \$3,952,144 for the previous twelve month period, September 30, 2008.²⁴⁵ ATM contended that when Blueflame was unable to fund Atmos' claims associated with losses arising from Hurricane Katrina due to scaling claims from Blueflame's reinsurance provider, Atmos treated the forgiven claims as an additional equity capital contribution of \$4.1 million. In addition to these contributed equity capital amounts, Blueflame has accumulated retained earnings of another \$7 million, as of December 31, 2009, arising mostly from charging the affiliates premiums in excess of incurred costs.²⁴⁶ According to a response by Atmos Pipeline – Texas to ATM RFI 6-10, the return on average equity for the year ended September 30, 2009 was 82%.

ATM argues the high Return on Equity (ROE) is the result of excessive premiums. ATM does not have an issue with the remaining premium components of the three component premium, just the amount retained by Blueflame for the deductible reimbursement coverage.²⁴⁷

ATM proposes an adjustment that allows a reasonable ROE plus actual cost based charges for expenses incurred by Blueflame.²⁴⁸ ATM asserts that Blueflame has only paid out two times historically since Blueflame was organized in 2003. A full deductible reimbursement attributed to Hurricane Katrina in 2005 and \$345,921 loss was paid for a compressor fire.²⁴⁹

ATM also claims that Atmos Energy Corporation has far exceeded the capital and surplus necessary to comply with the Bermuda statutory laws for liquidity and solvency. ATM maintains that the premiums paid by Atmos Energy Corporation is far more than the cost of premiums paid by Blueflame and are fully allowed in ATM's alternative calculations.²⁵⁰ ATM contends it would be more cost effective for Atmos Pipeline – Texas and SSU divisions to self insure as Atmos Energy Corporation has not provided any evidence that Blueflame is cost effective.

ATM argues that Atmos Energy Corporation has not explained why it elects to pay an affiliate company additional premiums of over \$2 million per year to reduce property insurance deductible from \$1 million to \$100,000. Atmos Energy Corporation has not explained why it could not accept these risks and reserve for them internally at a much lower cost. The corporation has not explained why Blueflame should continue its excessive charging for the "deductible reimbursement" coverage it provides after more than satisfying the Bermuda Statutory Ratios.²⁵¹

Derek W. Boyd, who testified on behalf of Atmos Pipeline – Texas²⁵² asserts that ATM is not quite representing the Blueflame expense of approximately \$6,100,000 and the company's allocated portion of \$909,000 in the correct perspective. For the premium paid,

²⁴⁴ *Id* at p. 44, Ins. 1-9.

²⁴⁵ *Id* at Ins. 12-14.

²⁴⁶ *Id* at p. 44, Ins. 18-23 and p. 45, Ins. 1-3.

²⁴⁷ ATM Initial Brief, p. 27.

²⁴⁸ ATM Ex. 2, p. 47, Ins. 4-6.

²⁴⁹ *Id* at p. 47, Ins. 23-24 and p. 48, Ins. 1-2.

²⁵⁰ *Id* at p. 49, Ins. 8-15.

²⁵¹ *Id* at p. 51, Ins. 12-18.

²⁵² Atmos Ex. 19.

Atmos Pipeline – Texas receives property insurance coverage of \$250 million per event with a \$100,000 deductible. By using Blueflame in the manner Atmos Energy Corporation does, after meeting the \$100,000 deductible, Atmos Pipeline – Texas does not have aggregation of flood and earthquake coverage which limits the number of covered losses in a period, as is done with typical insurance companies. Blueflame also includes coverage for named perils for underground storage caverns, underground storage contents and river crossing coverage which is not available at the Blueflame deductible and Blueflame pricing.²⁵³

Mr. Boyd states that ATM provided no evidence that the insurance coverage Blueflame provides could be obtained from any other source and no evidence to demonstrate that the premium charged by Blueflame is higher than that which would be charged by non-affiliates, no evidence to demonstrate that the cost to Atmos Pipeline – Texas is different than for other divisions of Atmos Energy Corporation and no evidence to demonstrate that the retention for deductible reimbursement coverage is not reasonable given the scope of potential claims across Atmos Energy Corporation's entire footprint.²⁵⁴

Mr. Boyd explains that Blueflame was formed for the purpose of providing the operating units of Atmos Energy Corporation a consistent property insurance rate over a long-term horizon and a continuity of insurance product. Mr. Boyd explains that the rates fluctuate over time in the insurance marketplace and Blueflame provides access to reinsurance markets directly without going through the general property insurance markets that would include profit, commissions, overhead and other transactional costs. Blueflame can access additional capacity in the insurance marketplace which ensures that Atmos Pipeline – Texas has competitive, consistent rates and a customized policy.²⁵⁵

Atmos Pipeline – Texas requested that AON (the third-party management company) perform a market study on behalf of Atmos Energy Corporation. Aon, according to Mr. Boyd, is one of the largest insurance brokers in the world and one of the two largest insurance brokers for utilities in the United States.²⁵⁶ The analysis shows that comparable insurance is not available and that less insurance coverage would be priced at approximately \$0.1258 per \$100 of gross plant.²⁵⁷ Aon also concluded that Blueflame was providing Atmos Pipeline – Texas with an additional \$0.0843 per \$100 of gross plant in value by including coverage that is not available to other natural gas pipelines.²⁵⁸

Mr. Boyd also argues that Atmos Pipeline – Texas needs the hurricane insurance because the utility has assets in Harris, Fort Bend and Waller Counties. Clearly Hurricane prone areas and, therefore, a need for hurricane insurance exists. Mr. Boyd also argues that ATM mischaracterizes the premium paid by Atmos Energy Corporation for the first layer of insurance (the first \$1 million after the deductible of \$100,000) as profit.²⁵⁹ He maintains that Blueflame, like any other insurer, needs to retain a portion of its premium so that it has the

²⁵³ *Id* at p. 4, lns. 6-11.

²⁵⁴ *Id* at p. 4, lns. 17-23 and p. 5, lns. 1-2.

²⁵⁵ *Id* at p. 5, lns. 5-17.

²⁵⁶ *Id* at p. 6, lns. 6-11.

²⁵⁷ *Id* at lns. 12-15, Exhibit DWB-R-1.

²⁵⁸ *Id* at lns. 15-17.

²⁵⁹ *Id* at p. 7, lns. 20-22 and p. 8, lns. 1-2.

reserve to cover the long-term expense of providing the million dollar per event coverage.²⁶⁰ The 82% ROE cited by ATM is more accurately described as an increase in the amount of retained reserve.²⁶¹ Mr. Boyd also notes that the 82% was for a select period of time and other periods would yield different results.

Mr. Boyd states that insurance premiums are based on a long-term horizon. By focusing on a single year in an effort to dispute the reasonableness of the premium, ATM disregards industry practice.²⁶² He also contends that Blueflame provides access to the reinsurance market, a lower rate, more coverage and allows for consistency and financial certainty.²⁶³

Examiner's Recommendation

Atmos Pipeline – Texas clearly has the burden of proof in this docket. The Examiners find that the company's filing included sufficient evidence to satisfy the affiliate transaction standard. Based upon that evidence provided by the company, the Examiners find that the expense is reasonable and necessary and the price to the gas utility is no higher than the price charged by the supplying affiliate to the other divisions of Atmos Energy Corporation. In light of the evidence provided by the utility, some evidence, other than the allegation of the Intervenor witness, must be provided to shift the burden back to the company. Merely, raising an allegation is insufficient. Evidence must be introduced into the record that shows that the company's allocated amount of insurance is unreasonable, or that the rate charged Atmos Pipeline – Texas is unreasonable, or that Atmos Pipeline – Texas could obtain more coverage for the same rate or less. ATM's premise that Blueflame must be charging more than cost and that Blueflame's rate must be excessive because the retained reserve is too high is not substantiated by evidence of a comparison of other insurance company's rates for similar coverage or that the retained reserve is higher than similar insurance companies. The fact is, insurance companies must have adequate reserves. Evidence has not been introduced that substantiates allegations that Blueflame's level of reserves is excessive.

In GUD No. 9670, the Commission found the services provided by Blueflame were reasonable and necessary and that the price charged Atmos Mid – Tex was not higher than the price charged by Blueflame to other affiliates or divisions, or to a third party.²⁶⁴ In GUD No. 9762, the Commission again found that the property insurance expense was just and reasonable.²⁶⁵ In GUD No. 9869, the Commission found that Atmos Mid – Tex had established that the expenses related to Blueflame for property insurance are reasonable and necessary.²⁶⁶ In addition, the Commission found that the price paid was not higher than the prices charged by Blueflame to other affiliates or divisions or to a nonaffiliated person or entity for property insurance.²⁶⁷

²⁶⁰ Id at p. 8, lns. 14-16.

²⁶¹ Id at lns. 21-22.

²⁶² Id at p. 10, lns. 4-16.

²⁶³ Id at p. 13, lns. 4-11.

²⁶⁴ Final Order GUD No. 9670, FOF 182.

²⁶⁵ Final Order GUD No. 9762, FOF 88.

²⁶⁶ Final Order GUD no. 9869, FOF 63.

²⁶⁷ Id

The company provided a summary analysis completed by Aon showing the rates charged by Blueflame to Atmos Energy Corporation for the level of service provided was lower than what a third-party provider would charge. ATM did not provide an analysis of what a third-party charges similar companies with similar assets and services nor did they show what other insurance companies hold as reserves for the assets insured. On this issue, insufficient evidence was introduced to establish that Atmos Energy Corporation has paid too much or that the reserve of Blueflame to high. The Examiners recommend the Commission find the rates charged by Blueflame are just, reasonable and necessary and that the rate charged is not more than the rates charged by Blueflame to its affiliates or divisions or to a nonaffiliated person.

11. Revenues

a. Adjustment to Other Revenue

The total test-year level of Other Revenue was \$89,995,892.²⁶⁸ Atmos Pipeline – Texas proposed a downward adjustment to this amount. Mr. Erskine recommended that this amount be reduced by \$11,463,464. He argued that the adjustment reflects known and measurable changes in the company's Other Revenue category resulting from post-test-year changes to certain transportation, storage and electric generation agreements. These changes are the results of terminated agreements, new agreements, and amended pricing and/or volume terms in existing agreements.²⁶⁹

Atmos Pipeline – Texas proposes a reduction to the revenue requirement for 'Other Revenue'. Other Revenue is revenue received from negotiated rate customers, the non Rate CGS and Rate PT customer class.²⁷⁰ Crediting the revenue requirement with revenue received from non-jurisdictional (such as irrigation or agricultural customers) or negotiated rate customers (customers that have negotiated rates under Tex. Util. Code § 104.003) to reduce the revenue deficiency is a typical method the Commission has done in previous rate cases.

The utility made a downward adjustment to the per book amount of Other Revenue for known and measurable changes in the contracts with these negotiated rate customers in the amount of \$7,926,548. Thus, Atmos Pipeline – Texas proposed Other Revenue to be \$81,715,298, as adjusted.²⁷¹ The adjustment made by the company reflects its review of contracts that have terminated, new contractual agreements and amended pricing and/or volume terms in existing contracts.²⁷²

ATM's Michael L. Brosch contends the company's review was subjective and biased.²⁷³ ATM argued that Atmos Pipeline – Texas removed approximately \$5.5 million from Other Revenue attributed to Customer 82 because the contract was scheduled to end December 31, 2010.²⁷⁴ One of ATM's adjustments was to add back the \$5.5 million because Atmos Pipeline – Texas was negotiating a new contract with this customer. The applicant responded that

²⁶⁸ Atmos Ex. 3, Schedule A-1, ln. 1, col. (c).

²⁶⁹ Atmos Ex 6 Direct Testimony of Richard A. Erskine, p. 16, ln. 18 – p. 17, ln. 6.

²⁷⁰ Atmos Ex. 6, Direct Testimony of Richard A. Erskine, p. 16, lns. 21-22.

²⁷¹ Atmos Ex. 3, Errata Filing 2, January 7, 2011, Schs. A, A-1, A-2.

²⁷² Atmos Initial Brief, p. 39.

²⁷³ ATM's Initial Brief, p. 16.

²⁷⁴ ATM Ex. 2, Direct Testimony of Michael L. Brosch, p. 14, lns. 9-16.

neither it nor ATM had any guarantees a successful new agreement would result in the same terms as the terminated agreement. The actual renewal contract with customer 82 resulted in the company adding back to Other Revenue \$779,503²⁷⁵ in Errata 2, as opposed to the \$5.5 million.²⁷⁶ ATM responded in their Initial Brief that, "The record reflects that, even if no firm new revenues have been secured via contract to fully replace Customer 82 revenue losses, ongoing negotiations with other customers and changes in short-term revenues may fully offset such losses."²⁷⁷

ACSC's Constance T. Cannady proposes the cost of service be allocated to the Other Revenue class.²⁷⁸ If the Commission elects to treat Other Revenue as proposed by Atmos Pipeline – Texas, she recommends an increase from approximately \$82 million to \$88.7 million.²⁷⁹ Ms. Cannady's recommendation is to average the historical levels of Other Revenue from 2006 through March 2010. The result is \$88,681,809. Ms. Cannady cites to the treatment of Other Revenue in the rate case of Lone Star Gas Company and TXU prior to GUD No. 9400. In those previous cases, the cost of service was allocated to all classes. Ms. Cannady contends the treatment of Other Revenue was changed in GUD No. 9400 by crediting the revenue requirement. Atmos Pipeline – Texas responded to Ms. Cannady's proposed adjustment to increase Other Revenue by pointing to the recent trends of pricing and volumes that indicate a decline. Using the previous periods does not reflect the current trend.

Examiner's Recommendation

The Examiners view the proposed adjustment ATM desires as speculative assuming the company is able to fill the void of volumes and dollars Customer 82's new contract has created. Atmos Pipeline – Texas may or may not be able to negotiate one or more contracts that will make up the difference in the two contracts for Customer 82. If the applicant was to make up the volume, it logically would have to be at a higher price or higher margin which is unlikely given the competitive market conditions.

Ms. Cannady's proposed method of cost allocation is in contrast to the historical practice of the Commission of crediting the revenue requirement for non-rate regulated revenue since GUD No. 9400, some six years ago. In addition, because of the market competitiveness it is difficult to accept that the level of Other Revenues will be the same as it was in previous periods. Averaging Other Revenue to arrive at an adjustment using periods that the price of natural gas has been higher would effectively inflate the adjustment, given current market pricing. The Examiners also note that if the Commission approves the Rider Rev, a higher amount of Other Revenue could have the reverse action to the Rate CGS and Rate PT customers, because if Atmos Pipeline – Texas cannot achieve the ACSC's proposed \$88.7 million, the Rider Rev adjustment will result increase to the rates.

The Examiners do not find ATM's reasoning behind its recommended adjustment valid for Customer 82's revenue losses. The Examiners recommend denying ATM's adjustment.

²⁷⁵ Atmos Initial Brief, p. 39-40.

²⁷⁶ APT Ex. 3, Errata Filing 2, January 7, 2011, Schs. A, A-1, A-2.

²⁷⁷ ATM Initial Brief, p. 18.

²⁷⁸ ACSC Ex. 2, Direct Testimony of Constance T. Cannady, p. 42, Ins. 18-22.

²⁷⁹ ACAC Ex. 2c, Highly Sensitive/Confidential Schedule CTC-10 to Direct Testimony of Constance T. Cannady.

The Examiners do not find reasonable the averaging of previous years to arrive at ACSC's adjustment. Typically, the reason to use an average over several periods is to recognize an anomaly or potential for an anomaly. Otherwise, the approach of a 13-month average or a test year end is appropriate. The Examiners find that Atmos Pipeline – Texas has provided sufficient evidence to support the use of test year end, as adjusted, for Other Revenue. The Examiners recommend rejection of Ms. Cannady's proposed 4.25 year average.

b. Retention Gas

ATM's Michael L. Brosch recommends an adjustment to retention gas sales. Under Rider RA, Atmos Pipeline – Texas retains one percent of the gas that is delivered into the company's system for redelivery to Rate CGS and Rate PT customers as 'Retention Gas.'²⁸⁰ This retained volume is used for compressor fuel and gas losses.²⁸¹ During the test year, Atmos Pipeline – Texas sold \$60,362 in retention gas.²⁸²

Mr. Brosch contends an adjustment is necessary because the test year contains an unusually low level of gas retention sale revenues compared to previous periods. Based upon the company's response to ATM RFI 6-20, Atmos Pipeline – Texas provided the following evidence of previous retention sale amounts.

Table 11.1²⁸³

Calendar Year 2007	\$2,012,250
Calendar Year 2008	\$3,417,100
Calendar Year 2009	\$2,881,173
Year to Date September 2010	\$4,896,562

Mr. Brosch recognized that current market prices have changed since 2007 – 2009 and has calculated an adjustment based on an average of excess volumes at \$4.40, the December 8th Katy Hub price.²⁸⁴ Using the volumes sold in the previous years, Mr. Brosch took an average volume of 458,755 MMBtu, less the volume associated with the test-year sales volume (the \$60,362 associated volume), at \$4.40 per MMBtu to arrive at this adjustment of \$2,018,520.

Atmos Pipeline – Texas responded to Mr. Brosch by arguing that adjustment reflects a speculative assumption that the utility will continue to make excess sales at the same historical levels.²⁸⁵ Atmos Pipeline – Texas also challenges ATM's assumption that the company will have excess volumes for sale in the future and neither is a known and measurable change.²⁸⁶

Examiner's Recommendation

²⁸⁰ ATM Ex. 2, Direct Testimony of Michael L. Brosch, p. 19, lns. 14-16.

²⁸¹ *Id* at lns. 19-20.

²⁸² *Id* at p. 20, lns. 4-5.

²⁸³ *Id* at p. 20, lns. 12, Table 2.

²⁸⁴ *Id* at p. 21, lns. 4-9.

²⁸⁵ APT Initial Brief, p. 40.

²⁸⁶ *Id*

The Examiners find the challenge with retention gas sales similar to the proposed adjustment for Other Revenue except that the position of the parties are reversed. In this instance, the Examiners find the test-year sales are, in fact, abnormally low and do not reflect historical sales of retention gas volumes. Atmos Pipeline – Texas included \$60,362 for retention gas sales when evidence proves historical sales exceed \$2 million annually over the past three years. This is the type anomaly the Examiner referenced in the previous section. Mr. Brosch's approach is reasonable for calculation of an adjustment using average sale volumes at a current market price. The Examiner's find that ATM's proposed adjustment of \$2,018,520 for retention gas sales is just and reasonable.

12. Rate of Return

a. Introduction

In setting a gas utility's rates, the regulatory authority shall establish the utility's overall revenues at an amount that will permit the utility an opportunity to earn a reasonable return on the utility's invested capital used and useful in providing service to the public in excess of its reasonable and necessary operating expenses. The regulatory authority may not establish a rate that yields more than a fair return on the adjusted value of the invested capital used and useful in providing service to the public.

As noted by the Austin Court of Appeals in *Railroad Commission of Texas v. Lone Star Gas Company*, to achieve the rate of return that a utility should be allowed to earn, the regulatory agency should consider the cost to the utility of its capital expressed as follows: (1) interest on long-term debt; (2) dividends on preferred stock; and (3) earnings on common stock.²⁸⁷ As stated by the United States Supreme Court, the annual rate that will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties The return should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time, and become too high or too low by changes affecting opportunities for investment, the money market, and business conditions generally.²⁸⁸

²⁸⁷ *Railroad Commission of Texas v. Lone Star Gas Company*, 599 S.W.2d 659 (Tex. App. C Austin 1980).

²⁸⁸ *Bluefield Water Works and Improvements Co. v. Public Serv. Comm'n of West Virginia*, 262 U.S. 679 (1923), see also, *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1942).

b. Discussion of the Evidence

Atmos Pipeline – Texas proposed a 12.75% return on equity (ROE) with a capital structure of 50.50% common equity and 49.50% long-term debt and a cost of debt of 6.87%. This translates into a 9.841% overall rate of return (ROR). The company's witness Robert B. Hevert provided testimony supporting its request.²⁸⁹ Mr. Hevert's showed a range of 11.50% to 13.25% for ROE, with an average at 12.75%.²⁹⁰ Atmos Pipeline – Texas is also proposing a capital structure of 50.50% common equity and 49.50% long-term debt.²⁹¹ Atmos Pipeline – Texas also proposed a cost of debt equal to 6.87%.

Mr. Hevert based his recommended ROE primarily on the Discounted Cash Flow (DCF) model. However, Mr. Hevert also considered the results of the Capital Asset Pricing Model (CAPM) to assess the reasonableness of the DCF results. In order to arrive at his recommendation, Mr. Hevert selected a proxy group, which he asserts is fundamentally comparable to Atmos.²⁹² Included in his analysis is recent economic and financial markets and business risk. Mr. Hevert divided his analysis into seven sections.

Table 12.1

Section 1	Regulatory Guidelines & Financial Considerations
Section 2	Current Capital Market Conditions
Section 3	Proxy Group Selection
Section 4	Data and Methodology
Section 5	Specific Business Risks
Section 6	Capital Structure
Section 7	Summary of Recommendations

Mr. Hevert explains that standards established by the United State's Supreme Court in *Hope and Bluefield* determine fairness or reasonableness of a utility's ROE. Those standards are: 1) consistency with other business' having similar or comparable risks, 2) adequacy of the return to support credit quality and access to capital, while maintaining financial integrity, and 3) the principle that the specific means of arriving at a fair return are not important, only that the end result leads to just and reasonable rates.²⁹³

Mr. Hevert asserts that the required cost of capital, including ROE, is a function of prevailing and expected financial market conditions.²⁹⁴ Mr. Hevert emphasizes the current financial market crisis and recession has led to a general decrease in the availability of, and increased cost of, both debt and equity capital for all market sectors, including utilities.²⁹⁵ Mr. Hevert cites a report by Moody's that "new conditions will make it harder to draw down on the lending facilities, putting energy borrowers' rating at risk. Those companies needing to renew

²⁸⁹ Atmos Ex. 10, Direct Testimony of Robert B. Hevert.

²⁹⁰ *Id* at p. 4, lns. 13-15.

²⁹¹ *Id* at lns. 19-21.

²⁹² *Id* at p. 6, lns. 4-19.

²⁹³ *Id* at p. 6, lns. 14-20.

²⁹⁴ *Id* at p. 9, lns. 16-17.

²⁹⁵ *Id* at p. 10, lns. 3-5.

credit facilities that mature this year or in 2010 will especially feel the brunt of new credit constraints.”²⁹⁶ Mr. Hevert contends that the authorized rate of return in this proceeding will provide a signal to the financial community concerning the ability of Atmos Pipeline – Texas to meet its capital market needs.²⁹⁷

Mr. Hevert examined the company’s financial and operational characteristics to develop a proxy group. He recognized that Atmos Pipeline – Texas is an intrastate pipeline providing connections to three major Texas market centers: 1) Carthage, Katy, and Waha. Atmos Pipeline – Texas offers throughput service to third-parties and transports natural gas to Atmos’ Mid – Tex distribution division, other Local Distribution Companies (LDC), to industrial customers, and operates five underground natural gas storage facilities in Texas (with a working capacity of 36 Bcf).²⁹⁸ Atmos Pipeline – Texas also provides ancillary services such as parking and lending arrangements, blending and compression.²⁹⁹

Atmos’ credit rating is BBB+ with Standard and Poor’s (S&P), BBB at Fitch, Inc. and Moody’s rates Atmos at Baa2.³⁰⁰ Mr. Hevert selected companies for the proxy group that were publically traded, consistently paid dividends, had a senior bond and/or credit rating by S&P of BBB- and was primarily regulated natural gas transmission companies, an approach consistent with FERC guidelines.³⁰¹ Included in his analysis for selection of companies for a proxy group were the most recent Beta coefficients, Price-Earnings Growth ratios and projected ROEs for companies classified by Value Line as LDCs and Oil/Gas Distribution Industry Companies.³⁰² The conclusion drawn is that Oil/Gas Distribution Industry Companies (transmission pipeline companies) have a higher level of risk than do LDCs.³⁰³ Mr. Hevert selected the following for his proxy group:

Table 12.2

Company	Ticker
Boardwalk Pipeline partners, L.P.	BWP
Enbridge Energy Partners, L.P.	EEP
Energy Transfer Partners, L.P.	ETP
Enterprise Products Partners, L.P.	EPD
Kinder Morgan Energy Partners	KMP
Southern Union Company	SUG
Spectra Energy Corp.	SE
TC Pipelines, L.P.	TCLP

While Frank M. Tomicek, who testified on behalf of Staff, does not necessarily disagree with the proxy group selection of Mr. Hevert, Mr. Tomicek selected many of the same

²⁹⁶ *Id* at p. 11, lns. 3-6.

²⁹⁷ *Id* at p. 15, lns. 18-19.

²⁹⁸ *Id* at p. 18, lns. 12-17.

²⁹⁹ *Id* at lns. 17-18.

³⁰⁰ *Id* at p. 18, lns 19-20.

³⁰¹ *Id* at p. 19, lns. 9-13 & p.20, lns. 1-7.

³⁰² *Id* at p. 25, lns. 12-18.

³⁰³ *Id* at p. 26, lns. 1-7.

companies for his proxy group.³⁰⁴ The differences were El Paso Pipeline Partners and Oneok Partners as opposed to Spectra Energy and TC Pipelines. J. Randall Woolridge, who testified on behalf of ACSC, used the same proxy group as Atmos Pipeline – Texas for one of his proxy groups, Gas Pipeline Proxy Group.³⁰⁵ However, Mr. Woolridge used a second proxy group in his analysis, nine natural gas distribution/transmission companies.³⁰⁶ He argues that it is improper to consider Atmos Pipeline – Texas as an independent pipeline for cost of capital purposes.³⁰⁷ City of Dallas witness Daniel J. Lawton used 14 companies in his proxy group to arrive at a recommended ROE.

Mr. Hevert used a quarterly growth DCF Model and a Constant Growth DCF Model to estimate a high and low range for ROE. The quarterly growth DCF model approach is based on the theory that a stock's current price represents the present value of all expected cash flows.³⁰⁸ Mr. Hevert used 30, 90, and 180-day averaging periods for his calculations. The results of the Quarterly DCF Analysis are shown in the table below.

Table 12.3
Quarterly DCF Analysis³⁰⁹

	Mean Low	Mean	Mean High
30-Day Average	10.21%	11.83%	13.59%
90-Day Average	10.47%	12.10%	13.86%
180-Day Average	10.55%	12.18%	13.94%

The Constant Growth DCF Model requires the following assumptions: 1) a constant average growth rate for earnings and dividends; 2) a stable dividend payout ratio; 3) a constant price-to-earnings multiple; and 4) a discount rate greater than the expected growth rate. The yield is based on the proxy companies' current annualized dividend and, as with the Quarterly DCF analysis, average closing stock prices over the 30, 90, 180-trading days ended August 31, 2010. The results of the Constant Growth DCF analysis are shown in the table below.

Table 12.4
Constant Growth DCF Analysis³¹⁰

	Mean Low	Mean	Mean High
30-Day Average	9.94%	11.49%	13.16%
90-Day Average	10.18%	11.73%	13.40%
180-Day Average	10.25%	11.80%	13.47%

³⁰⁴ Staff Ex. 3, Direct Testimony of Frank m. Tomicek, p. 7, lns. 10-14.

³⁰⁵ ACSC Ex. 1, Direct Testimony of J. Randal Woolridge, p. 13, lns 19-20.

³⁰⁶ *Id* at lns. 4-18.

³⁰⁷ *Id* at p. 25, lns. 12-14.

³⁰⁸ Atmos Ex. 10, Direct Testimony of Robert B. Hevert, p. 52, lns. 15-17.

³⁰⁹ *Id* at p. 57, ln. 16.

³¹⁰ *Id* at p. 60, ln. 12.

The Intervenor also used the DCF model and CAPM models plus Comparable Earnings Analysis and a blended approach. Each intervening party provided slightly different results in their analysis. The DCF results are shown in the table below.

Table 12.5
Intervening Parties DCF Analysis

	ACSC		ATM	RRC Staff	City of Dallas	
	Gas Proxy	Pipeline Proxy			Constant Growth	Non-Constant Growth
ROE Rate	8.5%	11.0%				
Mean			8.6%	11.73%		
Mean Low			7.9%	11.06%	9.8%	9.5%
Mean High			9.6%	12.56%	10.0%	10.1%
Median			8.2%			
Median Low			7.7%			
Median High			9.2%			

Because each Intervenor provided a slightly different presentation for results of their analysis, the following summarizes the results recommended by the Intervenor:

ACSC: 8.5% to 11.0%

ATM: 8.5% to 9.5%

RRC Staff: 11.06% to 12.56%

City of Dallas: 9.8% to 9.9%

As mentioned previously, Mr. Hevert also used the Capital Asset Pricing Model (CAPM) as a separate evaluation technique. The CAPM is a risk premium approach that estimates the cost of equity for a given security as a function of a risk-free return plus a risk premium to compensate investors for the non-diversifiable or systematic risk of that security. According to the CAPM theory, because unsystematic risk can be diversified away, investors should be concerned only with systematic risk, which is measured by Beta. Since both the DCF and CAPM models assume long-term investment horizons, Mr. Hevert used the 30-year Treasury yield as estimates of the risk-free rate. The results of the CAPM analysis are shown in the table below.

Table 12.6
Ex-Ante CAPM Results³¹¹

	Current 30-Year Treasury (3.86%)	Projected 30-Year Treasury (4.22%)
<i>Current Calculated Beta</i>		
DCF Derived Market Risk Premium	12.17%	12.53%
Sharpe Ratio Derived Market Risk Premium	12.68%	13.04%
<i>Average Historical Beta</i>		
DCF Derived Market Risk Premium	13.16%	13.52%
Sharpe Ratio Derived Market Risk Premium	13.73%	14.09%

The Intervenor also performed an analysis using the CAPM approach. The differences between Atmos Pipeline – Texas and the Intervenor are the proxy group selection and time period of the data. The following table summarizes the CAPM results of the Intervenor.

Table 12.7
Intervenor CAPM Results

	ACSC		ATM	RRC Staff	City of Dallas
	Gas Proxy	Pipeline Proxy			
ROE Range	7.5%%	8.5%	7.2% - 7.3%	6.53% - 12.22%	9.0% - 9.30%

The City of Dallas also included a Risk Premium analysis that showed a range of 9.52% to 10.24%, with a mid-point of 9.85%.³¹² City of Dallas witness Mr. Lawton suggests the ROE for Atmos Pipeline – Texas should be 9.75%, correcting cost allocation, eliminating the Rider Rev and over-earning from other revenues. If the Commission adopts the company's proposed allocation and Rider Rev, then a lower ROE is recommended, 9.30%.³¹³

Staff proposes an upper range ROE at 12.15%. However, if the Commission approves the Rider Rev, the upper limit should be at 11.80%, recognizing the reduction in business risk.³¹⁴

ATM also provided a Comparable Earnings analysis showing a range of 9.5% to 10.5%, or 10% mid-point.³¹⁵ ATM's recommendation for an ROE is 9.0% to 10.0% or a 9.5% mid-point.

³¹¹ *Id* at p. 68, ln. 8.

³¹² Dallas Ex. 3 Direct Testimony of Daniel J. Lawton, p. 28, lns. 9-10

³¹³ *Id* at p. 31, lns. 11-16.

³¹⁴ Staff Ex. 3, Direct Testimony of Frank M. Tomicek, p. 22, lns. 5-14.

³¹⁵ ATM Ex. 3, Direct Testimony of David C. Parcell, p. 38, lns. 7-8.

ACSC witness Woolridge uses a blended approach to recommend an ROE of 9.78%.³¹⁶ This blended approach recognizes that only a portion of company's throughput has a higher risk.

Robert J. Smith, who testified on behalf of Atmos Pipeline – Texas proposes a capital structure of 50.50% common equity and 49.50% debt. Since Atmos Pipeline – Texas is a division of Atmos Energy Corporation, Atmos Pipeline – Texas does not issue its own debt. The proposed capital structure represents Atmos Energy Corporation's actual structure at June 30, 2010, adjusted to reflect the corporation's \$100 million accelerated repurchase program of outstanding common stock. The stock repurchase agreement was announced on July 1, 2010.³¹⁷ ACSC, Staff, ATM and the City of Dallas do not contest the company's proposed capital structure and cost of debt.

Examiner's Recommendation

To summarize, the Examiners find the following proposed ROE recommendations by the Intervenors for ROE.

APT:	12.75%
ACSC:	9.78%
ATM:	9.5%
Dallas:	9.30% if the Commission approves APT's allocation and Rider Rev, or 9.75% correcting cost allocation, denying the Rider Rev and over-earning from other revenues.
Staff:	11.80% if the Commission approves Rider Rev, or 12.15% denying the Rider Rev.

The parties agree that the company's proposed capital structure and cost of debt is appropriate. The Examiners find the only differences in the proxy groups used by the parties is that the Intervenors were divided on whether it is appropriate to use companies that are master limited partnerships and distribution versus pipelines. The Examiners did not find sufficient evidence to support that using a master limited partnership (MLP) is inappropriate. Becoming a MLP seems to be the trend of business. Additionally, the selection of a proxy group that is distribution in nature does not properly reflect the business risk of Atmos Pipeline – Texas. ATM argues that Atmos Pipeline – Texas does not have the corresponding risks and uncertainties of independent pipeline companies. The Examiners were not persuaded by the arguments that Atmos Pipeline – Texas is more distribution in function than that of a pipeline company.

The Examiners note that there are fundamental differences between distribution companies serving captive residential, commercial and industrial customers as opposed to a pipeline company who has customers with a competitive alternative. Much of the company's throughput is to these customers with a competitive alternative. As Staff stated, Atmos Pipeline – Texas business segment activities wholly consist of intrastate pipeline transmission

³¹⁶ ACSC Ex. 1, Direct Testimony of J. Randal Woolridge, p. 45, lns 5-6.

³¹⁷ APT Ex. 10, Direct Testimony of Robert B. Hevert, p. 72, lns. 14-20.

operations, and the company's business segment revenues are derived from transmission service customers and subject to competition from other pipeline companies in their service region. The Examiners agree with Staff's position.

The Examiners find the use of the DCF model, CAPM, Risk Premium, Comparative Earnings Analysis and blending approaches reasonable methodologies and typical analyses for determining ROE. The Examiners recognize that each of these models is inherently subjective. Determining the appropriate ROE is always a highly contested issue in rate cases. The approaches to each calculation and the underlying data account for the primary differences in results. The Commission has set the ROE in a number of cases for distribution utilities since GUD No. 9400 where a 10% ROE was set. In GUD No. 9869 (an Atmos Mid-Tex Division rate case), the Commission set ROE at 10.4%. In GUD No. 9988 (A Texas Gas Service rate case), the Commission set the ROE at 10.33%. In GUD No. 9902 (a CenterPoint Energy rate case), the Commission set the ROE at 10.50%. However, the Commission has not set an ROE for a pipeline company since GUD No. 9400 in 2005.

The Examiners observe dockets discussed above support a higher ROE than those recommended by the Intervenor, other than Staff. In GUD No. 9902, a recent CenterPoint gas distribution rate case, the Intervenor all agreed that the current economic conditions adversely affect a utility's ability to attract capital.³¹⁸ The Examiners in GUD No. 9902 "conclude that substantial evidence was presented that indicated that the current economic environment has adversely affected the utility industry. Thus it is reasonable to recognize that fact as the Commission determines the appropriate rate of return."³¹⁹ Support for a higher ROE is also indicative of the recent credit markets and access to capital for companies in the last several years.³²⁰ The Examiners recognize that the business risk for a pipeline company is greater than that of a distribution company. The Examiners find the company's proposed capital structure of 50.50% common equity and 49.50% long-term debt and a cost of debt of 6.87% to be just and reasonable. The Examiners also find that a ROE of 12.15% with no Rider Rev and 11.80% with the Rider Rev is just and reasonable.

13. Taxes

The company included estimates for both state and federal income taxes in its cost of service analysis. In the context of state taxes, ATM challenged the methodology used to calculate the state gross margin tax. In the context of federal income taxes, ATM challenged the company's determination to not include certain deductions.

a. State Gross Margin Tax

The company calculated the estimated State Gross Margin Tax to be included in its cost of service calculation by multiplying 1% to the company's estimated gross profits.³²¹ ATM contended that this calculation was not accurate because the company failed to take into account the apportionment of margin that actually occurs when the company prepares the actual state

³¹⁸ GUD No. 9902 Proposal For Decision, p. 77.

³¹⁹ *Id*

³²⁰ *Id*

³²¹ Atmos Ex. 3, Errata (January 7, 2011), Schedule F – 6.

gross margin tax. Application of the provision in the Texas Tax Code at Section 171.106 results in a lower taxable margin than the calculation of gross profits derived in the cost of service study. That section of the Tax Code requires application of a ratio: The numerator of the ratio is the entity's gross receipts from business done in the State of Texas and the denominator of the ratio is the taxable entity's gross receipts from the entire business.³²²

Mr. Peterson and Mr. McDonald responded by noting that the calculation made by Mr. Brosch deviates from prior Commission practice. They also asserted that the process proposed by Mr. Carver requires incorporation of revenues from non-jurisdictional and non-utility operations into the calculations of the gross margin tax expense. He stated that the difference between the stand-alone tax for Atmos Pipeline – Texas and the tax on the books for Atmos Pipeline – Texas is due to the per books tax expense being calculated on a combined basis including all regulated and non-regulated operating divisions of Atmos Energy Corporation. He noted that the stand-alone tax calculation used in the company's rate case is based on the gross margin of the utility in the jurisdiction addressed in that rate case.³²³

The Examiners find that for purposes of estimating the cost of service in this proceeding, the company has established that its estimate of the gross margin tax is just and reasonable. It is appropriate to base cost of service calculations upon the utility operations. The proposed modification incorporates revenues from non-regulated operations and revenues from outside of the State of Texas. As noted above, the denominator of the applicable ratio would be based upon the gross receipts from the "entire business." In the case of Atmos Energy Corporation that figure would be based upon revenues from non-regulated enterprises and regulated activities in several other states. Finally, section 104.055 provides that the income tax rates shall be computed using the statutory income tax rates.³²⁴ The parties dispute whether the gross margin tax is an income tax. The Examiners find that, in fact, the state gross margin tax operates as an income tax. Regardless, the calculation of the company is consistent with the statutory method set out in this section.

b. Tax Deduction for Savings Plan Dividends

ATM contended that the federal income tax calculation failed to recognize a recurring income tax deduction that is enjoyed by Atmos Energy Corporation. Atmos Energy Corporation deducts on its tax returns the dividends that are paid on the entity's shares held in employee Retirement Savings Plan ("RSP") accounts. Mr. Brosch asserted that this recurring deduction should be reflected in the company's tax calculation.³²⁵ Mr. Petersen responded on behalf of Atmos Pipeline – Texas by noting that the proposed adjustment is inconsistent with prior Commission practice and inconsistent with the Gas Utility Regulatory Act.³²⁶

³²² ATM Ex. 1, Direct Testimony of Michael L. Brosch, pp. 37 – 41.

³²³ Atmos Ex. 20, Rebuttal Testimony of Pace McDonald, pp. 19 – 24 & Atmos Ex. 21, Rebuttal Testimony of Thomas H. Petersen, pp. 25 – 26.

³²⁴ Tex. Util. Code Ann. § 104.055(c).

³²⁵ ATM Ex. 1, Direct Testimony of Michael L. Brosch, pp. 57 – 58.

³²⁶ Atmos Ex. 21, Rebuttal Testimony of Thomas H. Petersen, pp. 26 – 27.

The Examiners find that the company has established that its calculation of federal income taxes is just and reasonable. Section 104.055 of the Texas Utilities Code provides as follows:

If an expense is allowed to be included in utility rates, or an investment is included in the utility rate base, the related income tax deduction or benefit shall be included in the computation of income tax expense to reduce the rates. If an expense is disallowed or not included in utility rates, or an investment is not included in the utility rate base, the related income tax deduction or benefit may not be included in the computation of income tax expense to reduce the rate. The income tax expense shall be computed using the statutory income tax rates.³²⁷

The Retirement Savings Plan dividends are not included in the utility rates and it is appropriate to exclude them from the calculation of income tax.

14. Allocation

a. Introduction

Once the cost of service is determined, the regulatory authority must determine the appropriate allocation of costs among the various customer classes. Atmos Pipeline – Texas provided a cost allocation and rate design proposal through the testimony of J. Stephen Gaske. As explained by Mr. Gaske, the cost to serve each customer class is determined by allocating the different cost components of the revenue requirement according to the proportional responsibility of each customer class for the use or incurrence of the cost.³²⁸

An underlying fact of the company's cost allocation proposal is the fact that the primary purpose of the system operated by Atmos Pipeline – Texas is to transport and store gas for the LDC market.³²⁹ While the company provides service to both regulated and unregulated industrial customers, the LDC's have the highest priority on the system and the system is designed to satisfy the gas demands of human needs customers as they vary throughout the year.³³⁰ With the exception of the regulated city gate rate and the exception of sixty-two on-system industrial customers that pay the regulated PT rate, the other customers on the system have competitive alternatives and Atmos Pipeline – Texas is able to pursue that business only by offering negotiated rates.

The company's services may be conceptually divided into three functions:

- Transportation
- Storage
- Mid-Tex WGIS

³²⁷ Tex. Util. Code Ann. § 104.055(c).

³²⁸ Atmos Ex. 11, Direct Testimony of J. Stephen Gaske, p. 11, lns. 7 – 15.

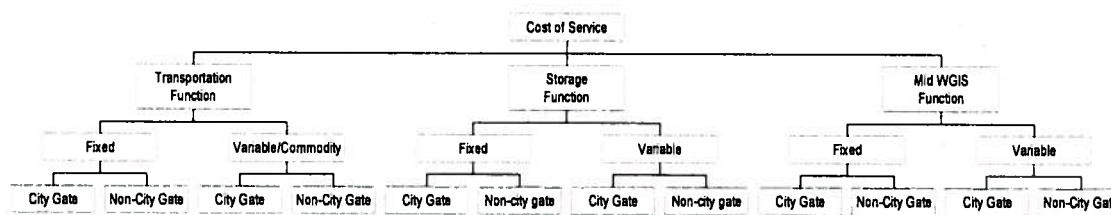
³²⁹ Atmos Ex. 6, Direct Testimony of Richard A. Erskine, p. 10, lns. 1 – 2.

³³⁰ Atmos Ex. 6, Direct Testimony of Richard A. Erskine, p. 10, lns. 14 – 22

Once the costs are “functionalized,” the costs are classified. The company proposed to classify costs into two categories: capacity-related or usage-related. Mr. Gaske explained that the classifications are made on whether the expenses are fixed or variable. Fixed costs tend to vary primarily with the amount of capacity and therefore are classified as capacity related. Variable costs tend to fluctuate in accordance with the level of throughput and are thus classified as usage-related. Once classified, the costs are allocated among the customer classes. The final step in the process is to credit net revenues from competitive and ancillary services to reduce the amount of costs allocated to the CGS and PT customers.³³¹

In this case the Examiners recommend a total cost of service to provide service to regulated customers (the LDC market segment and the on-system industrial segment) of \$225,605,564. Those costs will be functionalized, classified and allocated. The revenue from certain industrial customers, electric generation, through-system transportation customers, and ancillary service customers is \$83,723,391.63. Thus, the allocated costs are credited with the revenues from the non-regulated customers. This will establish the costs that each customer class must bear and rates are designed to recover those costs. Figure 1, below, summarizes the process to the point before the revenue credit is applied.

Figure 14.1
Functionalization, Classification, and Allocation



In Figure 1, above the non-city gate category includes regulated pipeline customers and Mid-Tex WGIS. It does not include the customers who generate “Other Revenues.” The costs for city gate and non-city gate customers are added the revenue credit, Other Revenues, is applied resulting in the net costs that must be recovered for each class of customers. Rates are established to recover those net costs.

The following issues have been raised with regard to the proposed allocation process: Functionalization and allocation of storage and transmission costs, the fixed cost allocation factor, and the company’s treatment of Other Revenues.

b. Functionalization and allocation of storage and transmission costs

Costs in each account were functionalized as being associated with either transportation, storage, or the Mid – Tex Working Gas in Storage. Certain costs related to these functions were directly assigned to functions based upon accounting records. Indirect costs were apportioned based upon ratios derived from direct plant or labor ratios.³³² Once the storage costs were functionalized they were classified as either fixed or variable. The fixed costs were allocated by

³³¹ Atmos Ex. 11, Direct Testimony of J. Stephen Gaske, pp. 12 – 13.

³³² Atmos Ex. 11, Direct Testimony of J. Stephen Gaske, p. 17, lns 11 – 21.

allocating half of the storage based on the amount of working gas capacity dedicated to a class or service, and half of the costs based on the maximum deliverability dedicated to the class or service. The variable costs were allocated based on the relative amount of injection and withdrawal usage of the storage facilities.³³³

The City of Dallas contended that storage costs should not be functionalized in a manner that essentially results in all storage expenses falling to the Atmos Mid – Tex customers. The City of Dallas contended that allocation of 99% of the storage expenses was inappropriate.³³⁴ In the testimony filed, it is apparent that an adjustment to the storage capacity was made by the City of Dallas but the basis of the adjustment is not clear.³³⁵

The company has established that the functionalization, classification, and allocation of storage costs are reasonable. The ultimate allocation of costs reflects the fundamental cost causative fact that the vast majority of the storage capacity and maximum daily withdrawal capacity is under contract to the CGS customers.

c. Fixed Cost Allocation Factor

Mr. Gaske applied a 4MDU allocation factor to assign fixed transmission costs. This methodology allocates the capacity-related component of costs, the fixed costs, using the Maximum Daily Usage for each customer class to system-wide usage on the peak day of each of the four winter season months (December, January, February, and March). He contended that the 4 MDU allocation factor assigns the fixed transmission costs based on the amount of demand that each customer class places on the system during the peak day in each of the four months of peak demand and a demand-based allocation factor is appropriate because the system is primarily designed to meet the demand of customers at the time of the system peak. He contended that peak demand determines the amount of transmission capacity and costs incurred by the company.

Mr. Nalepa, who testified on behalf of ACSC, pointed out that the allocation of fixed costs using the 4MDU methodology assumes that the costs associated with the maximum load during the peak season should be divided among the customers creating such maximum peak load, regardless of the magnitude of their demand at other time so the day, month, or year, or how long they may use the demands they create. Mr. Nalepa proposed adoption of the Seaboard methodology originally developed by the Federal Power Commission. The Seaboard methodology apportions the fixed capacity-related costs equally between annual volumes and design-day volumes. He argued that this was appropriate because it was his view that the facilities are sized to supply not only the maximum demand but are also built to supply service on all days throughout the year. Mr. Nalepa pointed out that the Seaboard Methodology was approved in GUD Nos. 9670 and 9400. GUD No. 9400 was the last proceeding that involved this system, operated at that time by TXU Gas.³³⁶

³³³ Atmos Ex. 11, Direct Testimony of J. Stephen Gaske, p. 21, lns. 17 – 20.

³³⁴ City of Dallas, Initial Brief, p. 26.

³³⁵ City of Dallas Ex. 2, Schedule SEC – 2.

³³⁶ ACSC Ex. 3, Direct Testimony of Karl J. Nalepa, p. 11, ln. 1 – p. 23, ln. 3.

Mr. Brosch, who testified on behalf of ATM, concurred with much of Mr. Nalepa's testimony. He also noted that the proposed allocation was not consistent with Commission precedent as it applied to this particular system. He also explained that the company's allocation methodology accounts for why the company is recommending a 58.71 reduction in revenues from the regulated pipeline transportation customers, which would then cause the CGS customer to absorb a revenue increase of 40.4%. Mr. Brosch also challenged the contention that the system size is determined by the requirements of human needs customers. He alleged that several investment decisions to expand the system since the last rate proceeding were influenced not by human needs customers, but by the possibility of serving additional industrial customers. Mr. Lawton, who testified on behalf of the City of Dallas proposed an alternative similar to the Seaboard methodology: one-third of the costs on a demand basis and two-thirds of the costs on a throughput basis.³³⁷

In GUD No. 9400 the Commission made the following findings of fact:

Finding of Fact No. 136. An allocation factor for demand-related costs based exclusively on four maximum daily use days during the months of December, January, February, and March is not reasonable.

Finding of Fact No. 137. An allocation factor for demand-related costs that averages the Test Year delivered gas volumes for the four maximum daily use days during the months of December, January, February, and March with Test Year delivered gas throughput is reasonable.

Mr. Gaske did not challenge that the Commission has previously adopted the Seaboard methodology in prior proceedings related to this system. He noted however, that the Seaboard methodology was recently rejected in GUD No. 9902. Additionally, he noted that the Federal Energy Regulatory Commission ("FERC") has rejected this methodology and applied the straight-fixed variable rate design advocated by the company in this case.

The Industrial Gas Users ("IGU") filed a brief in support of the company's proposed allocation methodology. IGU stated that it did not seek to have rates of its member companies subsidized by other customers on the Atmos Pipeline – Texas system. On the other hand, IGU did not believe that its members should subsidize service to other customers on the system. IGU noted that its members face intense competition, both domestically and abroad, and payment of rates that exceed cost of service directly affects their ability to compete.

The Examiners find that the company has provided compelling evidence in this proceeding to support the proposed fixed cost allocation methodology proposed by Atmos Pipeline – Texas. The company established that the system is designed to satisfy the capacity requirements of human needs customers during peak demand. Peak demand determines the amount of transmission capacity and costs incurred by the company. The evidence established that the company simply incurs no marginal or incremental cost of capacity when additional volumes of gas are transported.

³³⁷ City of Dallas, Ex. 3, pp. 44 – 45.

Furthermore, by shifting fifty percent of the fixed costs the previously approved methodology would impose an exorbitant cost on 62 individual customers. The purpose imposing that cost would be to subsidize the costs of providing service to the CGS customers. The PT customers account for only 82 of the existing meters whereas, the CGS customers account for 693 meters. ACSC and ATM propose to transfer fifty percent of the fixed costs onto customers that account for approximately 10.5% of the meters. Furthermore, the annual throughput figures of the PT customer are dwarfed by the annual throughput of the CGS customers. PT customers account for 17,625,887 MMBtu, whereas CGS customers account of 194,976,544 MMBtu. Thus, the PT customers account for approximately 8.3% of the annual throughput. The Examiners find that it is not reasonable to allocate 50% of the costs to customers who account for only 8% of the annual throughput.³³⁸ As stated succinctly by Daniel J. Lawton, who testified on behalf of the City of Dallas, "In terms of size, whether measured in revenue contribution or volumes of throughput on the system, the PT class is the smallest of the three customer groupings."³³⁹ Accordingly, the Examiners find that the company's proposal is reasonable and it eliminates what may become an inequitable rate subsidy based upon the facts of this case.

d. Other Revenues

In this case, Atmos Pipeline – Texas has allocated the cost of service to the Rate CGS and Rate PT customer classes. The Other Revenue customer class (negotiated rate customers) did not receive an allocation of cost. Instead, the company proposes to credit the revenue requirement with the revenue received from this class of customer. Atmos Pipeline – Texas proposes to credit \$83,723,392 of Other Revenue to the revenue requirement. In addition, Atmos Pipeline – Texas proposes to implement the Rider Rev to adjust the Rate CGS and Rate PT classes with changes in Other Revenue.

City of Dallas' Daniel J. Lawton recommends the cost of service be allocated to all customer classes. ACSC's Karl J. Nalepa also recommends allocating costs to the 'Other Revenue' class.

City of Dallas represents the revenue credit approach is no longer the optimal or fair approach of assigning costs.³⁴⁰ Mr. Lawton represents 65.04% of the revenue requirement is allocated to the Rate CGS and PT classes while only 34.94% is allocated to the "Other Revenue" class.³⁴¹ Mr. Lawton compares this to throughput of Rate CGS and PT classes of 31.90% to 68.10% for 'Other Revenue'.³⁴² Mr. Lawton contends it is wrong for the captive customers to pay for two-thirds of the cost but only use one-third of the system facilities.³⁴³ Mr. Lawton recommends allocating one-third of the cost on a demand basis and two-thirds of the costs on a throughput basis. Mr. Lawton suggests the demand basis be calculated based on maximum daily quantity (MDQ). For the 'Other Revenue' class he has used a zero MDQ. For

³³⁸ Atmos Ex. 3, January 7, 2011 Errata, Schedule I.

³³⁹ City of Dallas, Ex. 3, p. 37, Ins. 14 – 16.

³⁴⁰ City of Dallas Ex. 3, Direct Testimony of Daniel J. Lawton, p. 38, Ins. 6-7.

³⁴¹ Mr. Lawton has calculated his percentage of 34.94% as \$81,715,298 / \$233,895,842, revised for the Errata filed January 7, 2011.

³⁴² City of Dallas Ex. 3, Direct Testimony of Daniel J. Lawton, p. 38, Table 11.

³⁴³ *Id* at p. 39, Ins. 5-7.

the calculation of the throughput basis, he has used test year throughput percentage. The following table shows Mr. Lawton's calculations.

Table 14.1

Description	CGS & PT	Other Revenue	Total
Demand Percentage	33.33%	0	0.3333
Throughput Ratio	31.90%	68.10%	
Throughput Weight	66.70%	66.70%	
Throughput Factor	21.27%	45.42%	0.6667
Allocation Factor	54.60%	45.40%	100.00%

ACSC's Karl J. Nalepa recommends allocating to the 'Other Revenue' class using the same methodology as Rate CGS and PT class.³⁴⁴ However, if the Commission adopts a revenue credit mechanism, then Mr. Nalepa recommends the credit be consistent with GUD No. 9400.³⁴⁵

Atmos Pipeline – Texas argues that ACSC and Dallas would have the commission treat Other Revenue as if it were a tariffed rate class rather than use these competitive revenues to offset total cost of service as is customary.³⁴⁶ Atmos Pipeline – Texas contends these tariffed customers benefit from the Other Revenue Atmos Pipeline – Texas has been able to attract, but it is important to understand that the Other Revenue business is subject to the vagaries of the market, and is not a reasonable basis on which to allocate fixed costs.³⁴⁷

The Commission has not allocated costs to negotiated rate customers since before GUD No. 9400. The negotiated rate customers clearly have a competitive alternative. The Examiners do not find that a change in the manner in which the Commission has treated this revenue in the past is just and reasonable. In fact, the changed market conditions from GUD No. 9400 make such a proposal particularly problematic. The Atmos Pipeline – Texas system has firm delivery obligations to the human need customers, Rate CGS. These human need customers benefit from the revenue credit of Other Revenue by Atmos Pipeline – Texas using the excess capacity to also provide competitive service to the negotiated rate customer. The Examiners do not find compelling evidence to support the ACSC or the City of Dallas recommendation to allocate costs to these customers. The Examiners find that the proposed treatment of other revenues by the utility is just and reasonable.

Neither of these proposals account for the effect of the competitive market inherent in the negotiated rates paid by the competitive transportation customers. ACSC and the City of Dallas propose to allocate significantly more costs to the competitive transportation customers than Atmos Pipeline – Texas is able to recover through negotiated rates in the current market. The proposal of the Intervenor penalizes the company for retaining competitive transportation customers and creates an incentive for the company to give up the competitive transportation business and simply recover all of its costs from regulated customers. The cost allocations proposed by the City of Dallas and ACSC create a substantial disincentive for retaining and

³⁴⁴ ACSC Ex. 3, Direct Testimony of Karl J. Nalepa, p. 25, Ins. 1-2.

³⁴⁵ *Id* at Ins. 10-11.

³⁴⁶ Atmos Initial Brief, p. 45.

³⁴⁷ *Id* at p. 46

attracting competitive transportation customers, which ultimately hurts CGS and PT customers when the level of Other Revenues used to offset the cost of service rates falls accordingly.

15. Rate Design

Currently, the company's rate design consists of three components. In this proceeding, Atmos Pipeline – Texas proposed to adopt a two part straight-fixed variable (SFV) rate design. Table 15.1 summarizes the components of the two proposed designs.

Table 15.1
Rate Design Comparison

Existing	Proposed by Atmos Pipeline – Texas
Meter Charge Monthly usage Demand Charge	Fixed customer charge Volumetric charge

The customer charges would be calculated as the product of the capacity charge and the customer's contract maximum daily quantity. The municipal Intervenor's opposed this change, whereas IGU indicated its support for the change. All parties agree that the structure of the rates would result in the recovery of the vast majority of all of the company's fixed costs through a fixed customer charge. The Intervenor's contended that the proposed rate design shifts risk away from the company and onto its customers. They also argued that this would have a deleterious effect on the company's competitive position. Additionally, they contended that the proposed rates send the incorrect price signal to customers that the incremental cost of capacity is unlimited. Additionally, they argued that the proposed rate design is somehow incongruous with the current pricing structure of pipelines that will result in wide swings. Mr. Nalepa asserted that these swings would result in customers paying lower rates in winter and higher rates in summer.

Mr. Gaske pointed out that the Commission has in recent years been moving towards an SFV rate design for utilities under its jurisdiction. This has been reflected in the adoption of a rate design with a high fixed customer charge and low variable commodity charge. This allows the utility to recover more of its fixed costs through its fixed customer charge. He noted that in GUD No. 9869 the Commission stated as follows:

Finding of Fact No. 59. Atmos' proposed minimum customer charge for all rate classes, as shown in the attached schedules, are reasonable because they will allow for a higher recover of fixed costs and result in a rate structure that is more de-coupled from volume usage than Atmos' previous rates.

Additionally, the company contended that the methodology proposed by ACSC has been phased out over the last forty years. Mr. Gaske argued that the existing rate design sends improper price signal because it creates the impression that there is a low cost of capacity and a high cost

of transporting additional throughput on existing facilities. He argued that it would, in fact, be inefficient to discourage incremental throughput.

The Examiners find that the proposed SFV rate design is just and reasonable. Contrary to the allegations of the Intervenor, the SFV sends the correct price signals as it relates to pipeline transportation: By recovering fixed, demand-related costs in a fixed, demand-related charge the SFV rate design more accurately reflects the way in which costs are incurred. Thus, it provides better price signals and incentives for a customer to efficiently manage capacity needs and more fairly assigns costs. Additionally, as pointed out by the Intervenor, from the LDC perspective costs of transportation are passed through the purchase gas adjustment clause and the residential customer may experience a decrease in rates during the winter month. Finally, the rates of nearly all interstate natural gas pipelines in the United States are designed using a SFV rate design.

Finally, in the context of allocation and rate design, the Examiners note that the allocation and rate design provided by ACSC do not result in recovery of the revenue requirement identified by ACSC. ACSC recommended a total revenue requirement of \$206,575,413, prior to application of any revenue credit. The result of the rates proposed by ACSC, however, is a total operating revenue of \$200,538,500.

16. Regulatory Asset

This section addresses the Regulatory Asset approved in GUD No. 9869, an Atmos Mid-Tex rate case, as it relates to *Ad Valorem* Taxes and Accumulated Deferred Income Tax (ADIT) associated with Working Gas in Storage (WGIS).³⁴⁸ The area under discussion regarding storage originates in GUD No. 9400, a rate case involving Atmos' predecessor TXU Gas Company. In GUD No. 9400, TXU Gas Company filed its rate case with the distribution function and the pipeline function intertwined. The case developed a separate cost of service for each function (distribution and pipeline). The Commission included working gas in storage in the pipeline rate base but left the related *Ad Valorem* Tax and ADIT in Distribution's revenue requirement. The treatment was continued in the subsequent Atmos Mid-Tex rate cases, GUD Nos. 9670 and 9762. However, in the last Atmos Mid-Tex rate case, GUD No. 9869, the Commission removed these items from distribution's revenue requirement and authorized Atmos to create a regulatory asset for consideration in the next Atmos Pipeline-Texas case, which is this one. A regulatory asset was necessary because of the timing difference between GUD No. 9869 and this case.

In this proceeding, Atmos Pipeline-Texas calculated the regulatory asset by the difference between the revenue requirement for the distribution system with *Ad Valorem* Tax and ADIT included and the revenue requirement without those costs included.³⁴⁹ For Dallas and the environs (the environs affected by GUD No. 9869), the difference in annual revenue requirement is approximately \$880,000 per year.³⁵⁰ Since the rate change was implemented in April 2010, five months of the asset has accrued \$366,335.³⁵¹ The rate change for the rest of the

³⁴⁸ Nunc Pro Tunc Order, FOFs 64 and 65.

³⁴⁹ Atmos Ex. 8, Direct Testimony of Thomas H. Peterson, p. 9, lns. 20-22.

³⁵⁰ *Id* at p. 10, lns. 1-2.

³⁵¹ *Id* at lns. 3-4.

distribution system was implemented in October 2010, with the difference in annual revenue requirement for the remaining portion of the distribution system is approximately \$2.7 million.³⁵² The regulatory asset will accrue at \$228,000 each month for this portion of the system.³⁵³ Atmos Pipeline – Texas is proposing to include working gas in storage with the *Ad Valorem Tax* and ADIT, in the company's revenue requirement in this case.³⁵⁴ If the proposal is adopted, the regulatory asset will stop accruing with the implementation of the rates. Atmos Pipeline – Texas is proposing to recover the regulatory asset over a one-year period through a separate surcharge to Atmos Mid – Tex each month, plus accrued interest.³⁵⁵

ATM's Steven C. Carver affirmed via a response to an ATM RFI that Atmos Pipeline – Texas intends to collect the Dallas (and environs) portion of the regulatory asset from Dallas (and Environs) and the Settled Cities³⁵⁶ portion from the Settled Cities.³⁵⁷ ATM concurs with this approach and recommends the Settled Cities' Customers only be billed for the regulatory asset deferrals that originated with the Settled Cities.³⁵⁸

Atmos Pipeline – Texas proposes the surcharge be charged only to Atmos Mid-Tex through the Rider CGS – Mid-Tex. Storage is only available to Atmos Mid-Tex. APT's other customers do not have access or use storage.

City of Dallas opposes the treatment of the regulatory asset. City of Dallas argues the Commission did not have the jurisdiction to create the regulatory asset.³⁵⁹ Additionally, City of Dallas asserts Atmos Mid-Tex, as a customer, should have intervened in this case and did not.³⁶⁰ City of Dallas recommends the deferred asset be disallowed.

Examiner's Recommendation

The City of Dallas did not provide any evidence that supports its contention that the Railroad Commission of Texas did not have regulatory authority to allow Atmos to create a regulatory asset for *Ad Valorem Tax* and ADIT. In fact, the City of Dallas provided no evidence prior to its initial brief that it considered this an issue. The Examiners find that the proposed surcharge is just and reasonable.

The surcharge will be implemented through the Rider - WGIS Working Gas Regulatory Asset Surcharge to Atmos Mid-Tex in Rate CGS – Mid-Tex. ATM is in agreement with Atmos Pipeline – Texas regarding the treatment of the regulatory asset and the Examiners recommend the Commission adopt the company's proposed methodology for a surcharge to the applicant's

³⁵² *Id* at Ins. 6-8.

³⁵³ *Id* at Ins.8-9.

³⁵⁴ *Id* at Ins. 9-11.

³⁵⁵ *Id* at Ins. 15-18.

³⁵⁶ In GUD No. 9762, all of the City groups (the "Settled Cities") except the City of Dallas settled with a negotiated settlement that included the implementation of a Rate Review Mechanism. The Settled Cities did not participate in GUD No. 9869, the docket that approved the regulatory asset. ATM is one of the Settled City groups.

³⁵⁷ ATM Ex. 1, Direct Testimony of Steven C. Carver, p. 65, Ins. 19-21.

³⁵⁸ *Id* at Ins. 21-23.

³⁵⁹ City of Dallas' Initial Brief, p. 6.

³⁶⁰ *Id*.

customers for twelve-months to recover the deferred asset with interest on the unrecovered balance.

17. Tariffs – Rider Rev

Atmos Pipeline – Texas has requested a revenue tracking mechanism that will adjust Rate CGS and Rate PT annually to reflect the change in revenues Atmos Pipeline – Texas receives from its ‘Other Revenue’ customer class, Rider Rev. – Revenue Adjustment.³⁶¹ The mechanism is designed to compare the changes in other revenue from one year to the level of ‘Other Revenue’ determined in this docket and allocate 75% of that difference to Rate CGS and PT classes.³⁶² Other Revenue represents revenues received from the negotiated rate side of the revenue stream. This revenue is from negotiated sales and transportation. The Commission does not set these negotiated rates, they are considered just and reasonable under TEX. UTIL. CODE § 104.003(b). In previous rate cases involving revenue received from the negotiated rate customer class, the Commission has reduced the revenue requirement used to set rates in the amount of test year revenue associated with non-regulated revenue, such as agriculture and negotiated rate customers.

Atmos Pipeline – Texas contends the adoption of this mechanism is important since it will reduce the need for a general rate case in instances where the primary driver is the annual change in Other Revenues.³⁶³ In setting the rates for Rate CGS and Rate PT customers in this rate case, the Cost of Service has been offset by the amount of the company’s Other Revenue, net of the Commission’s revenue-related taxes. Atmos Pipeline – Texas witness John J. Reed testified that Atmos Pipeline – Texas has three customer segments: 1) the LDC customer segment; 2) the on-system (those directly served by Atmos Pipeline – Texas) industrial segment (except for certain industrial customers served under negotiated rates and are in the Other Revenue segment); 3) the Other Revenue segment consisting of industrial customers, electric generation and through-system transportation (customers that utilize Atmos Pipeline – Texas to deliver volumes to another pipeline) customers and, ancillary services such as storage.³⁶⁴

Atmos Pipeline – Texas represents this revenue has fluctuated widely in years past and is unpredictable because it is dependent upon a competitive market. Because it is unpredictable and has varied in years past, Atmos Pipeline – Texas proposes an adjustment that will compare the amount of Other Revenue determined in this case and Other Revenue in annual periods subsequent to this case. The concept of this revenue adjustment is to maintain the same level of Other Revenue, or close to the same level, as determined in this rate case for the utility to maintain a stable stream of revenue. Since the revenue requirement used to set the rates for CGS and PT classes is reduced by the \$83,722,392 of Other Revenue, it will lower the rates for the regulated rate classes, CGS and PT.

Mr. Reed, who testified on behalf of Atmos Pipeline – Texas, identifies the LDC segment as representing 51% of the total Atmos Pipeline – Texas revenue and has the highest

³⁶¹ Atmos Ex. 6, Direct Testimony of Richard A. Erskine, p.5, lns. 10-12.

³⁶² Atmos Ex. 1, Rider Rev.

³⁶³ Atmos Ex. 6, Direct Testimony of Richard A. Erskine, p.5, lns. 18-21.

³⁶⁴ Atmos Ex. 14, Direct Testimony of John J. Reed, p.5-6, lns. 21-22 and 1-5, respectively.

priority service.³⁶⁵ The on-system industrial segment represents customers served under Rate PT that do not have a competitive alternative and provides 4% of the total revenue to Atmos Pipeline – Texas.³⁶⁶ The third segment are the negotiated rate customers providing 45% of the total revenue to Atmos Pipeline – Texas.³⁶⁷ The third segment's revenue is Other Revenue. It is the annual revenue from Other Revenue customers that Atmos Pipeline – Texas proposes to track with its Rider Rev.

Mr. Reed asserts that the Texas natural gas market is becoming more competitive and less predictable. These changes are driving the need for new gas transmission capacity while raising the risk profile of natural gas transmission companies operating in the state.³⁶⁸ Further, Mr. Reed states the key elements of competition for natural gas pipeline service are location, price and quality of service. The pipeline must be located close enough to economically serve the customer and because "through-system" service is usually "hub-to-hub" or major supply basin to hub, there are often multiple pipelines providing the same service, making it highly competitive.³⁶⁹

J. Stephen Gaske, who also testified on behalf of Atmos Pipeline – Texas, has stated that "there is a desire on the part of APT to provide a more stable and predictable stream of revenues to cover its costs which tend to be fixed."³⁷⁰ Mr. Gaske further provides that the FERC has recently permitted a pipeline, Ruby Pipeline, LLC., a similar adjustment.³⁷¹ Mr. Gaske contended that because of the 75-25 percent split, Atmos Pipeline – Texas would have an incentive to maximize its other revenue as earnings to Atmos Pipeline – Texas would still be greater.

The Rider Rev. would be implemented by apportioning to each class in the same proportion that Other Revenue is allocated to each class in this preceding. The capacity charge adjustment would be calculated for each class by dividing the total annual adjustment allocated to each class by the then-current MDQ for each class, and then dividing that result by twelve to obtain the monthly amount of the adjustment.³⁷² Some of the factors likely to impact Other Revenue are changes in volumes and changes in market value of capacity forcing a change in competitive rates.³⁷³ Atmos Pipeline – Texas seeks to provide a more stable and predictable stream of revenues to cover its costs which tend to be fixed.³⁷⁴

ATM, ACSC and RRC Staff have challenged the legality, necessity, and alleged defects contained in the calculation, and the lack of studies by Atmos Pipeline – Texas to justify the Rider Rev.

³⁶⁵ *Id* at p.6, lns. 9-17.

³⁶⁶ *Id* at p. 7, lns. 3-7.

³⁶⁷ *Id* at p. 7, lns. 16-17.

³⁶⁸ *Id* at p. 4, lns. 4-7.

³⁶⁹ *Id* at p. 9, lns. 6-10.

³⁷⁰ J. Stephen Gaske – Direct, page 31.

³⁷¹ *Id* at page 31.

³⁷² Atmos Ex. 11, Direct Testimony of J. Stephen Gaske, p.30, lns. 9-14.

³⁷³ *Id* at p. 30, lns. 18-21.

³⁷⁴ *Id* at p. 30, lns. 6/8.

ATM witness Michael L. Brosch filed direct testimony recommending the Commission not approve the Rider Rev because, in part, it is inappropriate piecemeal ratemaking, no financial need is shown and it shifts the risk from the shareholders to the rate payers. Mr. Brosch argues that the fundamental flaws of the Rider and the company's lack of research to support such a request. Mr. Brosch represents the Rider Rev as proposed is piecemeal ratemaking as it addresses a single issue and does not meet the matching principle of ratemaking. The utility should be matching revenue and costs (expenses, rate base, rate of return), not just the revenue increase or decrease from negotiated customers. There have been no studies conducted by Atmos Pipeline – Texas showing future range fluctuations of how the fluctuations would affect rate and revenue impacts to the Rate CGS and PT customers. Nor has Atmos Pipeline – Texas conducted any formal studies on revenue sharing percentages.

Mr. Brosch contends the Rider Rev dilutes the financial incentive for Atmos Pipeline – Texas to aggressively market the pipeline and storage facilities in competitive markets. Presently, the company's shareholders retain 100% of the revenue from Other Revenue customers and therefore are incented to maximize its revenue. The shift from shareholders to rate payers by transferring 75% of the gains or losses to Rate CGS and PT ratepayers significantly dilutes the incentive. The important consideration here is Rate CGS and PT customers have no influence on Other Revenue. These decisions are made by management.

Mr. Brosch explains that the Rider Rev provides for no written testimony, no prefiled workpapers, no discovery, no dispute resolution, and no funding for Intervenor review. And, Atmos Pipeline – Texas has made no commitment to defer GRIP or rate cases if Rider Rev is approved. Further, the requested Return on Equity of 12.75% does not reflect the reduced risk if Rider Rev is approved.

Finally, Mr. Brosch is concerned that the time allowed for review does not give the Commission Staff sufficient time to conduct a review. Atmos Pipeline – Texas would file its adjustment on August 15th of each year and implementation would be 77 days later on October 1st.

City of Dallas witness Mr. Lawton also considers the Rider Rev piecemeal ratemaking. Mr. Lawton points out that there is \$155 million dollars of other costs that could go up or down and Atmos Pipeline – Texas isn't tracking these.³⁷⁵ It is unfair to regulated customers to track only the non-rate regulated revenue. Mr. Lawton has noted that the Rider Rev does not account or recognize customer re-classifications from the negotiated rate Other Revenue class to the rate regulated Rate PT Class. A shift from one class of customer to the other is not tracked to reduce or add to the \$83 million, or the amount determined by the Commission as the benchmark.

Staff witness Lynne LeMon also challenged the legality of the Rider Rev and believes it is bad regulatory policy. Witness LeMon also considers the proposed Rider flawed.³⁷⁶ She notes that the Rider Rev is designed in part to enable Atmos Pipeline – Texas to recover competitive losses from customers who do not have competitive alternatives. Further, a policy concern raised by Ms. LeMon is that the Rider Rev could be viewed as unreasonably

³⁷⁵ City of Dallas Ex. 3, Direct Testimony of Daniel J. Lawton.

³⁷⁶ RRC Staff Ex. 2, Direct Testimony of Lynne M. LeMon, p. 3, Ins. 1-3.

preferential, prejudicial, and discriminatory.³⁷⁷ Further policy concerns are changes in revenue should be offset by changes in related costs, it creates a perverse incentive to cut costs unnecessarily. Ms. LeMon points out that from a policy standpoint, the Commission should not approve a rider that narrowly targets a declining revenue stream nor should the Commission interfere with the competitive market by shifting recovery of competitive losses to customers in a non-competitive market.

Ms. LeMon also sees a number of flaws in the rider. Rider Rev ignores the company's overall earnings, does not appear to consider prior period gains or losses, does not identify what the allocation to Rate CGS or PT customers is based on (dollars, volumes, number of customers, etc.), right of Atmos Pipeline – Texas to appeal a regulatory decision, unclear about Intervenor review, no customer notification and whether discovery is allowed.³⁷⁸ Ms. LeMon suggests that if the Commission were to approve a rider it should include a limit to two years on a trial basis, require a report and proportional allocation of the adjustment.

In its Initial Brief, the Commission contends that the Rider Rev ignores the company's overall earnings. As such, Atmos Pipeline – Texas might over earn its allowed Rate of Return. The City of Dallas, upon cross-examination of Mr. Gaske, showed that none of the companies at FERC which have had such clauses have the same type of split as Atmos Pipeline – Texas proposes, the clauses are not comparable.³⁷⁹ Further, the City of Dallas contends that since there is no mechanism to review the propriety of revenues proposed to be collected, the rider is a "recipe for mischief rather than sound regulatory policy".³⁸⁰

Atmos Pipeline – Texas argues that the Intervenor has complained of the inequity of Other Revenue fluctuation, most up, since GUD No. 9400 with no consideration of a credit. The Rider Rev provides for the credit between rate cases.³⁸¹ Mr. Erskine likens the Rider Rev to the Purchased Gas Adjustment (PGA) mechanisms approved throughout Texas. Further Mr. Erskine states the primary drivers of Other Revenue, market price, market spreads, and other competitors are out of APT's control, like gas cost through the PGA.³⁸²

With regard to customer shifting from one class to another without recognizing the potential movement of revenue and the effect it may have on Other Revenue, Mr. Erskine maintains that the total universe of customers that could do that is 10 representing \$1.5 million in revenue. Rate PT is only for those customers that are on-system industrial end-use customers.³⁸³ And, since Atmos Pipeline – Texas is a price-taker, the company has no incentive to price its service below market because of the implementation lag designed in the Rider Rev. Pricing below market prices would be a disadvantage to the shareholders as Ms. LeMon contends. Further, Rider Rev does not fix Other Revenue at a certain level. It adjusts the Rate CGS and PT up or down to reflect a portion of the changes each year.³⁸⁴

³⁷⁷ *Id* at p. 6, lns. 1-9.

³⁷⁸ *Id* at p. 8, lns. 1-21.

³⁷⁹ City of Dallas Initial Brief, p. 30.

³⁸⁰ *Id* at p. 31.

³⁸¹ Rebuttal Testimony of Richard A. Erskine, p. 17, lns. 6-12.

³⁸² *Id* at p. 17-18.

³⁸³ *Id* at p. 19, lns. 13-16.

³⁸⁴ *Id* at p. 20, lns. 17-21.

The Examiners found the facts in evidence persuasive regarding the Rider Rev. On the one hand, APT is attempting to satisfy the Intervenor's complaint that Atmos has enjoyed the benefits of increases in Other Revenue since GUD No. 9400. On the other hand, the Intervenor's complain the Rider Rev is unfair to the competition, unfair to the regulated class of customer, does not follow the matching principle, is not legal and does not provide for intervention, a hearing or substantive review.

The Gas Utility Regulatory Act provides that in establishing a gas utility's rates, the regulatory authority shall establish the utility's overall revenue at an amount that will permit the utility a reasonable opportunity to earn a reasonable return on the utility's *invested capital used and useful in providing service to the public* in excess of its reasonable and necessary operating expenses. The invested capital necessary to provide service to the regulated customer was identified in Schedule A, line 27, col D. That amount, as recommended by the Examiners is set forth on Table A, page iii of this Proposal for Decision. The appropriate rates required to provide a reasonable return based on the invested capital used and useful in providing service to the regulated customers are set forth in column (A) of the table on page iii of this Proposal for Decision. Absent the revenue credit from services provided to the unregulated customers, those are the rates required pursuant to sections 104.051 and 104.003.

Atmos Pipeline – Texas proposes to credit the expenses related to the utility's overall invested capital used and useful in providing service with revenues derived from sales to unregulated customers. Further, as with the purchase gas adjustment clause, Atmos Pipeline – Texas proposes to make an annual adjustment to rates based upon the other revenues. As was established in the record of this case, the company's other revenues increased over the last 5 years since rates were established in GUD No. 9400 by \$46.6 million. That is an average of \$9.3 million per year. Throughout those years the regulated customer was unable to benefit from that increased revenue. The company no proposes to remedy that historic disadvantage by implementing a rider that would allow it to credit the rates necessary to recover the invested capital used and useful in providing service to the public on an annual basis.

No costs are allocated to Other Revenue. The mechanism adjusts Rate CGS and PT rates for 75% of the change in revenue. In other words, the same methodology is used for crediting Other Revenue in this rate case as proposed in Rider Rev.

The Examiners have concerns regarding the time allowed to conduct a review, approximately 30 days.³⁸⁵ There may not be adequate time to conduct a substantial review. The Examiners have concerns regarding the level of detail of the current Other Revenue associated with each annual filing. There is no notice to the customer of any rate increase, unlike the COSA and GRIP. It is also not clear on whether discovery is allowed or is the review limited to the contents of the filing at the Commission.

The Rider as proposed does not provide the level of consideration that the Examiners feel is necessary for its approval. However, the Examiners do not feel the Intervenor's have fully supported their positions on over earning, piecemeal ratemaking, it being an illegal

³⁸⁵ Atmos Ex 1, Rider Rev. – Atmos files later than August 15th each year and the Commission has until September 15th to review.

adjustment or that the Rider is not good policy. As proposed, the Examiners recommend denying the Rider Rev. However, incorporating the suggestions of the Intervenor, the Rider Rev could address the concerns of the parties.

The Examiners recommend the Rider Rev identify specifically the method of allocation to the customer classes, i.e., number of meters, volumes, percent of revenue, etc. The Examiners recommend the Rider Rev extend the review period from 30-days to 60-days, incorporate language that provides for regulatory denial and appeal, provide an additional level of detail supporting the current other revenue, provide notice to the customers by bill insert or mail, allow for discovery, allow for regulatory review cost recovery and provide for a trial period of 3-years. At the end of the three-year trial period, Atmos Pipeline – Texas may request an additional three-years with the third-year filing and provide documentation why it should be continued for another three-year period. That documentation would show: 1) how the Rate CGS and PT customers have benefited from the use of Rider Rev, 2) Customers gained or lost, 3) Volumes and revenues for each of the three periods, 4) Customers shifted from Rate PT to Other Revenue and Other Revenue to PT. Additionally, if the change in rates generates additional revenue of more than 2 ½%, a hearing shall be held by the Commission. With the above modifications to the Rider Rev., the Examiners recommend its approval

The Commission will have the opportunity to evaluate the mechanism at the next rate case if GRIP is employed by the utility. That evaluation can occur approximately five years from the first IRA effective date.

18. Standardized Filing Package

Staff witness Lynne M. LeMon filed testimony recommending a standard rate filing package. Witness LeMon states that in GUD No. 9988/9992,³⁸⁶ the Examiners, Staff, Intervenor and the gas utility were all in favor of a standard rate filing package.³⁸⁷ In the Proposal for Decision in that docket, “[t]he Examiners do agree with Staff’s recommendation that the Commission initiate a rule-making to formalize the Commission’s requirements on the matching of accounts, the timing of updates to applications, the use of estimates, the inclusion of test year amounts and adjustment amounts in rate case schedules, and develop standardized rate filing package requirements. By adopting standardized rate filing package requirements, rate case expenses will be minimized and the Staff and Intervenor will be able to focus on other issues of interest to the Commission.”

Staff makes a similar argument in this docket. Ms. LeMon also states that such a package could contain language that would prohibit rate design application that includes a Rider REV, a “stand-alone basis source of revenue.”³⁸⁸ Ms. LeMon includes that a standardized filing package could include the terms of review for IRA filings, setting out what documentation is

³⁸⁶ GUD No. 9988/9992 was a Petition for De Novo Review of the Denial of the Statement of Intent filed by Texas Gas Service Company by the actions of the City of El Paso, Anthony, Clint, Horizon City, Socorro and Village of Vinton.

³⁸⁷ Staff Ex. 2, p.9, Ins. 22-27.

³⁸⁸ *Id* at p. 10, Ins. 10-17.

sufficient for an investment to be considered prudent and reasonable, whether a third-party audit is required, whether a statistical sample review is acceptable.³⁸⁹

Staff witness goes on the point out that given the impact of non-standardization on rate case expenses, the short time for adjudicating a rate case and the Commission's limited Staff resources, a comprehensive standard rate filing package is recommended.³⁹⁰

Atmos Pipeline – Texas witness Barbara W. Myers provided testimony in rebuttal that the rate filing package Atmos Pipeline – Texas filed was in the same format as GUD No. 9869 and 10041.³⁹¹ The format used in this case and the two previously mentioned cases began with the development of schedules in GUD No. 9670. Changes have been made to improve links. Atmos Pipeline – Texas does not believe a rate proceeding is the place to initiate a rule making such as the one Staff recommends. That type of rule making affects every gas utility in the State. Atmos Pipeline – Texas points out that no one has complained regarding the schedules, content of the information or the format of the filing.³⁹²

While the Examiners would agree that a standard rate filing package should reduce rate case expense and help to facilitate a more efficient rate review, the Examiners also agree that a rate proceeding for a policy decision is not the ideal venue for consideration of this issue. Certainly Staff, the applicant, or the Intervenors, may request a rulemaking. The Commission, of course, may at its discretion also initiate a rulemaking. The Examiners note that the filing made by the company in this proceeding may provide a reasonable starting point or template in any proceeding where such a rulemaking is undertaken. As previously noted by the Examiners, the filing made by Atmos Pipeline – Texas provided a level of transparency that was appreciated by the officers assigned to preside over this case.

³⁸⁹ *Id* at lns. 19-29.

³⁹⁰ *Id* at p. 11, lns 3-5.

³⁹¹ Atmos Rebuttal Myers Testimony, p. 58, lns. 8-12.

³⁹² *Id* at p. 59, lns. 18-20.

19. Conclusion

In this proceeding Atmos Pipeline – Texas requested an overall revenue requirement, offset by revenues derived from service provided to non-regulated customers, of \$155,703,729. The Examiners find the company has established that a revenue requirement of \$143,049,141, offset by revenues derived from service provided to non-regulated customers, is just and reasonable. This results in an overall increase to the company's revenues of \$26,150,965.

Respectfully submitted,



Gene Montes
Hearings Examiner
Office of General Counsel



Mark Brock
Technical Examiner
Gas Services Division

RAE-4

MAP OF COMPETITIVE PIPELINES

- ATMOS ENERGY PIPELINE
- ENERGY TRANSFER PIPELINE
- ENTERPRISE NATURAL GAS PIPELINE
- ENBRIDGE PIPELINE
- CROSSTEX PIPELINE
- KINDER MORGAN PIPELINE
- HOUSTON PIPELINE

Attachment 1