

**BEFORE THE STATE CORPORATION COMMISSION  
OF THE STATE OF KANSAS**

In the Matter of the Application of Atmos )  
Energy Corporation for Adjustment of its ) Docket No. 19-ATMG-525-RTS  
Natural Gas Rates in the State of Kansas )

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**POST-HEARING BRIEF OF THE**  
**CITIZENS' UTILITY RATEPAYER BOARD**

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January 15, 2020

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COMES NOW, The Citizens' Utility Ratepayer Board (“CURB”) and respectively submits its *Post-Hearing Brief* pertaining to the Application of Atmos Energy Corporation (“Atmos” or “the Company”), for approval of changes to its natural gas rates in the State of Kansas (“Application”). As to the issues heard at the December 10-12, 2019 hearing before the State Corporation Commission of the State of Kansas (“Commission”), CURB recommends that the Commission adopt its adjustments and modifications to Atmos’ requests and proposals in the Application. In support therefore, CURB states as follows:

### **I. Background**

1. On June 28, 2019, Atmos Energy Corporation filed an Application before the Commission seeking an overall net revenue increase of \$7.2 million through an increase in base rates by \$9.6 million, proposing a rate case expense surcharge of \$817,882, rebasing amounts currently collected through the Gas System Reliability Surcharge Rider ("GSRS") of \$3.3 million and adjusting \$1.4 million of the Ad Valorem Tax Surcharge Rider ("AVTS") into base rates. The \$4.7 million attributable to those riders will be moved into base rates.<sup>1</sup>

2. Furthermore, Atmos is requesting approval of a System Integrity Program (“SIP”) tariff, which Atmos proposes as a way to accelerate its progress in the replacement of obsolete pipeline material and to reduce the frequency of rate case filings.

3. On July 2, 2019, CURB filed a Petition to Intervene, which the Commission subsequently granted on July 25, 2019.

4. On July 16, 2019, Atmos, CURB, and the Staff (collectively “the parties”) for the Kansas Corporation Commission (“Staff”), filed a Joint Motion proposing a procedural schedule, setting deadlines for filing testimony, discovery requests and submissions, and the submissions of

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<sup>1</sup> See generally, *In the Matter of the Application of Atmos Energy Corporation for Adjustment of its Natural Gas Rates in the State of Kansas*, Docket No. 19-ATMG-525-RTS (filed on June 28, 2019) (Application).

post-hearing briefs. The procedural schedule was also approved by the Commission on July 25, 2019.

5. On October 31, 2019, CURB and Staff submitted pre-filed written testimony from their respective witnesses.

6. On November 18, 2019, Atmos filed written rebuttal testimony from its original witnesses and two additional witnesses who did not file direct testimony.

7. On November 22, 2019, the Parties participated in a settlement hearing to discuss a potential resolution to the disputed issues. Ultimately, the Parties were unable to reach an agreement.

8. From December 10-12, 2019, the Commission took live testimony from all parties during the Evidentiary Hearing.

9. On January 3, 2020, Atmos filed its Post-Hearing brief, detailing its position on the Application and requested relief from the Commission.

## **II. Rate of Return on Common Equity**

10. CURB recommends that the Commission approve a cost of equity of 8.7% for Atmos in this case. In these regards, Doctor J. Randall Woolridge sponsored testimony on behalf of CURB, supporting an overall cost of capital for the Kansas jurisdiction gas utility operations of Atmos.<sup>2</sup> Doctor Woolridge employed the Discounted Cash Flow Model (“DCF”) and Capital Asset Pricing Model (“CAPM”) to a proxy group he selected to estimate an equity cost rate for Atmos.<sup>3</sup> Based upon these studies, Doctor Woolridge posited a cost of equity in the range from 7.5% to 8.7%.<sup>4</sup> However, Doctor Woolridge relied primarily upon his DCF analysis to estimate the cost of

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<sup>2</sup> Direct Testimony of Doctor J. Randall Woolridge (Woolridge Direct Testimony), pg. 1, lns 17-18.

<sup>3</sup> Woolridge Direct Testimony, pg. 4, lns 13-17.

<sup>4</sup> Ibid.

capital for Atmos, because the CAPM requires an estimate of the market risk premium even while studies by academics and investment firms provide a wide variation in estimates of market risk premiums.<sup>5</sup> Therefore, Doctor Woolridge recommended the upper end of his cost of equity range (being 8.7%) as the equity cost rate for Atmos.<sup>6</sup>

11. Doctor Woolridge testified that an equity cost rate of 8.7% meets the standards for regulatory rates of return established by the United State Supreme Court in Bluefield Waterworks & Improvement Co. v. Public Service Comm'n of West Virginia, 262 U.S. 679 (1923) and Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1944).<sup>7</sup> In these regards, Doctor Woolridge notes that gas distribution companies, like Atmos, have earned rates of return in the 8.0% to 9.0% range in recent years.<sup>8</sup> Further, he points out that a market-to-book ratio of 2.20 for his gas proxy group shows that the earned Return on Equity (“ROE”) for gas companies are well in excess of the returns that investors require.<sup>9</sup>

12. Doctor Woolridge’s range of the equity cost rates for Atmos differed from the range presented by Atmos witness, Dylan W. D’Ascendis. With specific reference to the DCF, CAPM and Risk Premium Model (“RPM”) in his direct testimony, Mr. D’Ascendis’ initial range of equity cost rates for Atmos was from 8.92% to 9.94%.<sup>10</sup> Importantly, Mr. D’Ascendis had to revise his initial range of equity cost rates to a range from 9.01% to 9.64%.<sup>11</sup> Mr. D’Ascendis needed to revise his initial range of equity costs due to a decline in interest rates since the filing of his direct testimony.<sup>12</sup> Specifically, Mr. D’Ascendis’ rebuttal testimony contains a DCF equity cost rate of

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<sup>5</sup> Woolridge Direct Testimony, pg. 32, lns 8-21.

<sup>6</sup> Woolridge Direct Testimony, pg. 58, lns. 21-23.

<sup>7</sup> Woolridge Direct Testimony, pg. 60, lns 17-22 through pg. 61, lns 1-5.

<sup>8</sup> Ibid.

<sup>9</sup> Ibid.

<sup>10</sup> Direct Testimony of Dylan W. D’Ascendis (D’Ascendis Direct Testimony) (filed June 28, 2019), pg. 4, ln 1.

<sup>11</sup> Rebuttal Testimony of Dylan W. D’Ascendis (D’Ascendis Rebuttal Testimony) (filed November 18, 2019), pg. 4, ln. 3.

<sup>12</sup> D’Ascendis Rebuttal Testimony at pg. 5, lns 3-12.

9.01%, a RPM equity cost rate of 9.64%, and a CAPM equity cost rate of 9.1%.<sup>13</sup> The average of these equity cost rates is equal to 9.25%.

13. In order to escalate his recommended ROE of 9.9%, Mr. D'Ascendis employs a cost of equity model that utilizes non-price regulated companies, a size adjustment and a flotation cost adjustment.<sup>14</sup> Specifically, the equity cost rate for Mr. D'Ascendis' Cost of Equity Models Applied to Company Risk, Non-Price Regulation Companies is 10.23%, the size adjustment recommended by Mr. D'Ascendis is 0.40%, and the flotation cost adjustment recommended by Mr. D'Ascendis is 0.03%.

14. Mr. D'Ascendis' recommended ROE of 9.9% should be rejected by the Commission. First, his DCF analysis relies upon a perpetual growth rate that is not realistic. Mr. D'Ascendis' DCF analysis assumes that Atmos will be able to grow at 6.82% in perpetuity.<sup>15</sup> Second, it is not appropriate to apply a size adjustment to a company the size of Atmos. Moreover, Doctor Woolridge points out that, unlike industrial stocks, utility stocks do not exhibit a significant size premium.<sup>16</sup> Third, Mr. D'Ascendis' incorporation of Cost of Equity Models Applied to Company Risk, Non-Price Regulation Companies has not been accepted in Kansas, and should not be accepted now. As conceded by Mr. D'Ascendis, "[w]ith different companies you may or may not have different systematic risks depending on the circumstances. Some companies may be more subject to systematic risks that [Mr. D'Ascendis] alluded to than others."<sup>17</sup> As Commissioner Duffy pointed out during the Evidentiary Hearing, the breadth and depth of regulation of utility companies versus the companies used by Mr. D'Ascendis in his Cost of Equity Models Applied

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<sup>13</sup> D'Ascendis Rebuttal Testimony at pg. 4, lns 3.

<sup>14</sup> D'Ascendis Rebuttal Testimony, pg. 4, ln 3.

<sup>15</sup> Transcript of Evidentiary Hearing on December 10-12, 2019 (Tr.), Vol. 1, pg. 101, lns. 1-4.

<sup>16</sup> Woolridge Direct Testimony, pg. 94, lns 5-21; pg. 95, lns 1-10.

<sup>17</sup> Tr., Vol. 1, pg. 129, lns 13-19.

to Company Risk, Non-Price Regulation Companies is troubling. In her view, it's not even comparing apples to oranges: "It's not even a fruit. It's a vegetable."<sup>18</sup>

15. Moreover, Doctor Woolridge points out a number of flaws in Mr. D'Ascendis' DCF, RPM and CAPM analyses. With respect to his DCF analysis, Mr. D'Ascendis relies exclusively on the overly optimistic and upwardly biased earnings-per-share (EPS) growth rate forecasts of Wall Street analysts and Value Line; he also has combined abnormally high Value Line projected EPS for his proxy companies, computed from a three-year base period, with three-to-five year projected growth rates of First Call and Zack's.<sup>19</sup> In addition, Doctor Woolridge states that Mr. D'Ascendis' RPM approach is erroneous because the base yield is much higher than current utility bonds yields, and his risk premium analysis is based upon the same erroneous data and methodologies he uses in his CAPM analysis.<sup>20</sup> Finally, Doctor Woolridge notes that there are three errors in Mr. D'Ascendis' CAPM analysis: He uses a non-traditional CAPM approach; he employs an excessively projected long-term projected risk-free interest rate that significantly exceeds current market rates; and his market risk premium of 9.56% is much higher than published market risk premiums, not reflective of currently market fundamentals.<sup>21</sup>

16. However, even ignoring these errors, if one were to take the average of Mr. D'Ascendis' DCF, RPM and CAPM recommendations (9.25%) and compare it to Doctor Woolridge's recommendation of a ROE of 8.7%, the midpoint between the two would be an ROE of 9.0%. That ROE is located within the range of ROEs presented by Staff witness Adam Gatewood. Mr. Gatewood's recommended range of ROEs for Atmos is between 8.85% and 9.35%.

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<sup>18</sup> Tr., Vol. 1, pg. 131, lns 15-15.

<sup>19</sup> Woolridge Direct Testimony, pg. 62, lns 13-17; pg. 65, l. 8; pg. 68, ln 13.

<sup>20</sup> Id. at pg. 63, lns 12-17; pg. 68, ln 19; pg. 91, ln 4.

<sup>21</sup> Id. at pg. 62, ln 18; pg. 63, ln 2; pg. 92, ln 1-23 through pg. 93, ln 1.

The above midpoint is only 10 basis points below Mr. Gatewood's recommended ROE of 9.1%.<sup>22</sup>

17. Although CURB believes that an ROE of 8.7% is the appropriate authorized ROE, CURB recognizes that the Commission may find it too low in light of ROEs granted in recent rate cases. In view of that possibility, CURB believes that an ROE of 9.0% for Atmos, being slightly below the mid-point of Staff's ROE range, is the highest ROE that could be justified in this case. First, as Doctor Woolridge points out, Atmos enjoys a large amount of equity in its capital structure. "A utility cannot maintain an unusually high equity ratio and not to expect to have the resulting lower risk reflected in its authorized return on equity."<sup>23</sup> Secondly, gas distribution companies have been earning rates of return in the 8.0% to 9.0% range in recent years.<sup>24</sup> An ROE of 9.0% is at the high end of that range. Moreover, Atmos has requested a System Integrity Program ("SIP") which will certainly alleviate any problem with Atmos not earning its authorized rate of return due to capital expenditures made on accelerated pipeline replacement. No other Kansas gas utility can use both the GSRS and the SIP to recover pipeline replacement and other capital expenditures.

18. Atmos' chief criticism of Doctor Woolridge's ROE analysis is the claim that Doctor Woolridge relies exclusively on his DCF analysis. That claim is not true. Doctor Woolridge uses both the CAPM and DCF analyses in his testimony. However, due to his belief that the DCF analysis does not rely upon studies by academics and investment firms that provide a wide variation in estimates of market risk premiums, he used the higher range of his analysis.<sup>25</sup> Even so, if Doctor Woolridge were to posit the mid-point between the ROE under his DCF analysis (8.7%) and the ROE under his CAPM analysis (7.5%), he would have recommended an ROE equal

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<sup>22</sup> Direct Testimony of Adam Gatewood (Gatewood Direct Testimony), pg. 2, lns 10-12.

<sup>23</sup> Woolridge Direct Testimony, pg. 23, lns 8-10.

<sup>24</sup> Id. at pg. 60, lns 21-22 (referring to Exhibit JRW-5).

<sup>25</sup> Id. at pg. 32, lns 8-21.

to 8.1%. Thus, it is difficult to fathom how Atmos complains about Doctor Woolridge's decision to allow Atmos an ROE at the high end of his range.

19. Doctor Woolridge's recommended ROE of 8.7% in this case is the correct one. Doctor Woolridge uses a proxy group of nine natural gas distribution companies to evaluate the return on common stock requirements of investors.<sup>26</sup> He is the only cost of capital witness to do so. Secondly, economic growth and inflation have remained low.<sup>27</sup> Third, thirty-year Treasury yields, which began the year in the 3.0% range, have dropped as of August 2019, to almost 2.0%.<sup>28</sup> Consequently, over the past five years, with historically low interest rate and capital costs, Doctor Woolridge notes that authorized ROEs for regulated utilities have slowly declined to reflect the low capital cost environment.<sup>29</sup> Thus, Doctor Woolridge recommends that the Commission set an ROE based on these current indicators of market-cost rate and not speculate on the future direction of interest rates.<sup>30</sup>

20. In its post-hearing brief, Atmos complains that the ROEs recommended by Staff witness Gatewood and CURB witness Woolridge are too low, based upon the testimony of Gary L. Smith and the rebuttal testimony of John D. Quackenbush.<sup>31</sup> The testimony of these witnesses is not persuasive. Mr. Smith provides his take on how regulatory lag affects Atmos' ability to earn its rate of return on its capital investments. Importantly, the concept of regulatory lag (being Mr. Smith's principle concern) is being addressed in the SIP as proposed by all parties. Moreover, nowhere in the standards expressed by the United States Supreme Court in Bluefield or Hope Natural Gas does the Court indicate that a regulatory commission should award a utility a higher

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<sup>26</sup> Id. at pg. 18, lns 8-14.

<sup>27</sup> Id. at pg. 10, lns 11-12.

<sup>28</sup> Id. at pg. 10, lns 16-17; pg. 11, lns 1-2.

<sup>29</sup> Id. at pg. 15, lns 12-15.

<sup>30</sup> Woolridge Direct Testimony, pg. 12, lns 18-19.

<sup>31</sup> See, for example, Post Hearing Brief of Atmos Energy Corporation (Atmos Initial Brief), pgs. 4-7.

than reasonable ROE upon the basis that it may not actually earn the authorized ROE. To CURB's knowledge, in setting an authorized ROE, no regulatory agency considers the ability of a utility to actually earn that return. Clearly, it has been a regulatory maxim that a regulatory agency like the Commission must simply authorize a rate of return meeting the three criteria set forth by those cases. It is up to the utility to earn that authorized ROE.

21. Additionally, by comparing Kansas to other states, Mr. Quackenbush chastises this Commission for not setting ROEs at a high-enough level historically.<sup>32</sup> However, Mr. Quackenbush was unaware that in Atmos' various rate cases since the early 2000s, Atmos has agreed to the revenue requirement authorized by the Commission in all but one case.<sup>33</sup> Moreover, Mr. Quackenbush admits that ROEs should not be set on the basis of what other jurisdictions have authorized.<sup>34</sup> Although Mr. Quackenbush contends that low ROEs hurt ratepayers through increasing capital costs, Doctor Woolridge points out that lower authorized ROEs are unlikely to hurt the financial integrity of utilities.<sup>35</sup>

22. In short, the testimony of Atmos witnesses Smith and Quackenbush add very little, if any, to the issue of the appropriate ROE to be authorized by the Commission in this case. The analysis of Atmos witness D'Ascendis is flawed. Therefore, CURB recommends that the Commission adopt the recommendation of Doctor Woolridge in this docket and authorize an ROE of 8.7%. However, if the Commission were to reject Doctor Woolridge's recommendation, CURB believes that the Commission should, at the most, authorize an ROE between CURB's recommended 8.7% ROE and the average of Mr. D'Ascendis' DCF, CAPM and RPM analyses (a 9.25% ROE) to arrive at an ROE of 9.0%, which is within the range of ROEs recommended by

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<sup>32</sup> Rebuttal Testimony of John D. Quackenbush, pg. 15, lns 7-20.

<sup>33</sup> Tr., Vol. 1, pg. 208, lns 17-25 through pg. 209, lns 1-15.

<sup>34</sup> Tr., Vol. 1, pg. 208, ln 17; pg. 210, lns 12-24.

<sup>35</sup> Woolridge Direct Testimony, pg. 17, lns 1-20.

Mr. Gatewood.

### III. Capital Structure

23. CURB recommends that the Commission utilizes a capital structure for Atmos in this docket, as laid out in Doctor Woolridge's pre-filed testimony. CURB's capital structure is comprised of 43.68% long-term debt at 4.37% and 56.32% Common Equity at 8.7%.<sup>36</sup> Doctor Woolridge notes that Atmos is proposing a capital structure that includes significantly more common equity in financing its gas operations than the average of his gas proxy group.<sup>37</sup> He testified that when a regulated utility's actual capital structure contains a high equity ratio, a regulatory commission has options to either impute a more reasonable capital structure or to authorize a lower common equity cost in recognition of the downward impact that an unusually high equity ratio will have on the financing risk of the utility.<sup>38</sup> In other words, a utility cannot expect that its authorized rate of return will be unaffected by the lower risk associated with a high equity ratio.<sup>39</sup>

24. Nonetheless, Doctor Woolridge noted that on September 25, 2019, Atmos issued \$800 million of senior notes, which included \$300 million of 2.65% senior notes due in 2029 and \$500 million of 3.375% senior notes due in 2049.<sup>40</sup> This financing had a significant impact on Atmos' common equity ratio. As a result of this known and measurable change, Atmos' capital structure (as of September 25, 2019) was 43.68% long-term debt and 56.32% common equity.<sup>41</sup>

25. In view of these facts, Doctor Woolridge recommended that the Commission adopt a capital structure for Atmos that recognizes the September 25, 2019 financing.<sup>42</sup> Doctor

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<sup>36</sup> Id. at pg. 5, lns 3-4.

<sup>37</sup> Id. at pg. 20, lns 13-19.

<sup>38</sup> Id. at pg. 22, lns 21-23 through pg. 23, lns 1-2.

<sup>39</sup> Id. at pg. 23, lns 4-11.

<sup>40</sup> Woolridge Direct Testimony, pg. 23, lns 14-19.

<sup>41</sup> Id. at pg. 23, lns 20-21 through pg. 24, lns 1-6.

<sup>42</sup> Ibid.

Woolridge's recommendation is consistent with the options he outlined in his testimony. Moreover, it is fair to Atmos. Doctor Woolridge testified, (1) it reflects Atmos' actual current capitalization; (2) it includes a common equity ratio that is in line with the average common equity ratio of Doctor Woolridge's gas proxy group and (3) it does not include short-term debt (although short-term debt must be included in the capital structure in one-half of the states in which Atmos operates).<sup>43</sup> It is important to note that Regulatory Research Associates posits that the average authorized common equity ratio for gas distribution companies in calendar year 2018 was 50.09%.<sup>44</sup>

26. Atmos concedes, as it must, that the Commission may give effect to known and measurable post-test-year changes.<sup>45</sup> However, it complains that, in this case, to do so would violate the principle of synchronization in ratemaking.<sup>46</sup> This argument is somewhat bemusing, since Atmos is "all in" on non-synchronized surcharges designed to reduce the regulatory lag associated with its capital investments. In any event, Atmos' argument is not compelling. Essentially, Atmos is requesting that the Commission give effect to post-test year equity issuances that *may* occur in 2020. These issuances are post-hearing changes and certainly are not known and measurable today. Moreover, the average common equity ratio including/excluding short-term debt for the four quarters ending on March 31, 2019 for Doctor Woolridge's gas proxy group was 48.89%/56.86%.<sup>47</sup> To include the issuances of common equity requested by Atmos would move the common equity ratio of Atmos well beyond the average common equity ratio including/excluding short-term debt for the four quarters of Doctor Woolridge's gas proxy group.

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<sup>43</sup> Id. at pg. 24, lns 11-16.

<sup>44</sup> Id. at pg. 24, lns 15-17.

<sup>45</sup> Atmos Initial Brief, pg. 13, ¶22.

<sup>46</sup> Id. at pg. 15, ¶25.

<sup>47</sup> Woolridge Direct Testimony, pg. 20, lns 13-19.

27. Therefore, on the basis of the testimony in the record, CURB recommends that the Commission set Atmos' capital structure at 56.32% equity/43.68% debt. This common equity ratio is in line with the capital structure recommended by Staff.<sup>48</sup> It is also consistent with the capital structure authorized by other regulatory jurisdictions as it pertains to Atmos.<sup>49</sup>

28. Atmos concedes that "there is no single 'correct' capital structure that will pertain to all times going forward."<sup>50</sup> Yet, in spite of the fact that using end-of-test year capital structure in this case would result in a capital structure well outside of the norm, Atmos argues that the Commission is required to do so. Given the options that the Commission has to deal with Atmos' high common equity ratio (outlined in Paragraph 23 above), the capital structure posited by Doctor Woolridge is reasonable and should be adopted by the Commission.

#### **IV. System Integrity Program ("SIP")**

29. In 2011, following major natural gas pipeline incidents, the Pipeline and Hazardous Materials Safety Administration (PHMSA) issued a Call to Action to accelerate the repair, rehabilitation, and replacement of the highest-risk pipeline infrastructure. Pipeline material is one of the most significant risk indicators, and PHMSA has specifically indicated that pipelines constructed of cast/wrought iron and bare (i.e., uncoated) steel are among pipelines that pose the highest risk.<sup>51</sup>

30. Atmos estimates that its Kansas system has approximately 821 miles of bare steel pipe in the ground, most of which has been in place since before the 1960s.<sup>52</sup> This is only an estimate, as Atmos acknowledges that as it continues to do more research, it finds additional bare

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<sup>48</sup> Gatewood Direct Testimony, pg. 16.

<sup>49</sup> Id. at pg. 19, lns 1-4.

<sup>50</sup> Atmos Initial Brief, pg. 15, ¶25.

<sup>51</sup> Pipeline Replacement Background, PHMSA, <<https://www.phmsa.dot.gov/data-and-statistics/pipelinereplacement/pipeline-replacement-background>> (Last updated Sep. 20, 2019).

<sup>52</sup> Direct Testimony of Barton Armstrong (Armstrong Direct Testimony), pg. 2, lns 1-2.

steel.<sup>53</sup> Atmos' system does not contain cast or wrought iron pipe.

31. In order to try to accelerate the replacement of bare steel pipe as well as other obsolete or aged pipe, Atmos has proposed its System Integrity Plan ("SIP"). As Atmos proposes it, the SIP is a quarterly surcharge mechanism meant to support and recover the costs incurred by the Company as a result of its proposed acceleration of investment in obsolete pipe replacement projects. As proposed, the SIP would be a five-year mechanism subject to renewal or modification at the end of its initial term.<sup>54</sup>

32. As stated by Atmos, its proposed SIP is:

"critical to the Company's ability to comply with federal pipeline safety regulations and maintain an effective pipe replacement program. Atmos Energy must regularly inspect its system and proactively identify risks. Part of this proactive identification of risks involves acknowledging and investigating the known risks identified by the gas utility industry, not merely those identified through inspections of the Company's system. Once those risks are identified, Atmos Energy must implement and fund a systematic program designed to mitigate or, where possible, eliminate those risks. The SIP mechanism provides the funding necessary to work toward optimizing our safety program. Specifically, the SIP is intended to timely recover system safety and integrity costs associated with gas utility capital investments."<sup>55</sup>

33. It is important to note that there is already a legislatively-approved mechanism available to gas utilities, the Gas System Reliability Surcharge (GSRS), designed to accelerate investments related to safety, security, and risk management. The GSRS was established by K.S.A. Supp. 66-2202 through 66-2204. These statutes allow natural gas public utilities to utilize a monthly fixed (non-volumetric) surcharge providing recovery of infrastructure investments related to safety, security, and risk management (e.g., pipeline system components installed to replace, upgrade, or modernize obsolete facilities).

34. There have been recent, significant changes to the GSRS statutes. In 2018, the

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<sup>53</sup> Tr. Vol. 2, pg. 268, lns 1-22.

<sup>54</sup> Direct Testimony of Gary Smith (Smith Direct Testimony), pg. 21, lns 10-16.

<sup>55</sup> Armstrong Direct Testimony, pg. 6, lns 19-23 through pg. 7, lns 1-6.

defined expenditures covered by the GSRS were expanded from infrastructure system “replacements” to infrastructure system “investments.” For instance, investments in “system security” to protect cyber assets are now GSRS eligible. Additionally, the surcharge cap was doubled; the initial GSRS filing cannot establish a monthly charge of more than \$0.80 per residential customer over the base rates in effect and, thereafter, each change in the surcharge (effectuated no more often than every 12 months) cannot increase the monthly charge by more than \$0.80 per residential customer over the most recent GSRS filing. Atmos’ GSRS surcharge is currently at the maximum level.

35. Atmos has indicated that without the SIP, it would be forced to file more frequent rate cases, abbreviated rate cases or GSRS requests,<sup>56</sup> with all the associated costs and time involved. However, the testimony of Mr. Gregory at the evidentiary hearing confirms that at no point does Atmos agree not to file rate cases, even if all it asks for in the SIP is granted.<sup>57</sup> Atmos may still need to file another rate case within a short interval.

36. In this docket, both CURB and Staff have proposed specific plans they would like to see adopted by the Commission regarding the SIP. While not identical, both proposals are actual plans. By their own admission, Atmos has not proposed any specific plan.<sup>58</sup>

37. Many of the provisions requested by the CURB and Staff are based, to a large degree, on the terms of a similar SIP agreed to by the parties in a Unanimous Settlement Agreement in Docket 16-ATMG-079-RTS (Docket 16-079).<sup>59</sup> While the SIP portion of the Unanimous Settlement Agreement in Docket 16-079 was not approved by the Commission, it can be used as

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<sup>56</sup> Tr., Vol. 2, pg. 260, lns 1-11.

<sup>57</sup> Id. at pg. 263, lns 1-17.

<sup>58</sup> Tr., Vol. 2, pg. 272, ln 19-25 through pg. 273 lns 1-6.

<sup>59</sup> *Joint Motion to Approve Unanimous Settlement Agreement* in Docket No. 16-ATMG-079-RTS (filed on January 20, 2016) (16-079 Settlement Agreement), Attachment 1, pg. 8-11.

an example of the differences in what had been agreed to by the parties in the past and show how the proposed provisions in the current docket have changed.

38. During the Evidentiary Hearing in this docket, Atmos witnesses were questioned by CURB counsel about the specifics of the current Atmos SIP proposal, compared to the agreement reached in Docket 16-079. They acknowledged that there was no cap suggested in the Company's current proposal,<sup>60</sup> whereas in the Docket 16-079 there had been an agreed cap of \$75 million, proportionately spread over the course of the pilot program, if practicable.<sup>61</sup> The current Atmos proposal includes a request for a quarterly surcharge update, whereas the agreement in Docket 16-079 called for a semiannual surcharge update.<sup>62</sup> In Docket 16-079, Atmos agreed to a three-year rate moratorium with allowance for an abbreviated rate case.<sup>63</sup> Here, Atmos does not propose any kind of rate moratorium.

39. As CURB witness Josh Frantz testified in his pre-filed testimony<sup>64</sup> and during the Evidentiary Hearing<sup>65</sup>, CURB opposes the SIP proposed by the Company. However, with a few modifications, CURB would be more amenable to the program.<sup>66</sup>

40. CURB's proposed modifications include:

- a. the Company should first maximize its gas system reliability surcharge (GSRS) before additional investment is allocated to a SIP for that period;
- b. the Company should first invest in safety-related infrastructure beyond what is recoverable through the GSRS and depreciation before additional investment is allocated to a SIP for that period;
- c. SIP project eligibility should be limited to replacement of cast iron or bare steel pipeline infrastructure;
- d. the SIP surcharge should be updated annually, rather than quarterly as proposed;

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<sup>60</sup> Tr., Vol. 2, pg. 257 lns 5-10.

<sup>61</sup> Id. at pg. 257 lns 11-14.

<sup>62</sup> Id. at pg. 258, lns 12-14.

<sup>63</sup> 16-079 Settlement Agreement, pg. 7, ¶23.

<sup>64</sup> Testimony of Josh Frantz (Frantz Direct Testimony), pg. 2, lns 12-13.

<sup>65</sup> Tr., Vol. 2, pg. 394, lns 1-14.

<sup>66</sup> Frantz Direct Testimony, pg. 2 lns 13-15.

- e. the initial monthly SIP surcharge should be no more than \$0.40 per residential customer per month, and with each annual update, the SIP surcharge should not increase by more than \$0.40 per residential customer per month; and
- f. the Company should agree to an initial three-year rate moratorium.<sup>67</sup>

41. The CURB modifications to Atmos' proposed SIP and the Staff's modifications are almost identical. The major difference is that Staff proposes a cap of \$50 million of SIP expenditures over the five year pilot program (which is the equivalent of an approximate cap of \$0.60 per residential customer per month) and CURB's limit is \$0.40 per residential customer per month (which is the equivalent of approximately \$35 million of SIP expenditures over the five years).

42. Admittedly, some of CURB's proposed modifications differ from what was agreed to in Docket 16-079. However, the specific provisions in the Docket 16-079 SIP were proposed prior to the changes in the GSRS adopted by the Kansas legislature in 2018. The changes in the GSRS have heightened the concern for recovery of pipeline investments through depreciation. In view of these changes, it is clearly not in the interest of Kansas residential and small commercial ratepayers to carry all aspects of the prior SIP proposal forward to the current proposal.

43. Regarding CURB's first two modifications, Mr. Frantz believes the SIP is not necessary in light of the Company's current level of investment:

"Atmos is already recovering all of its infrastructure investments through depreciation and GSRS. At a high level, this is actually illustrated in the testimony of Atmos's witness Gary Gregory. Mr. Gregory states, 'Atmos Energy invested \$64.4 million in Kansas from 2016 to 2018, 82% of which has been in risk-based Distribution Integrity Plan safety-related infrastructure... \$32.1 million - or 50% of this safety-related investment - has been above and beyond that qualified for recovery through the [GSRS]. This investment also is about double the depreciation expense reflected in our rates.' He goes on to state that 'this level of investment without an enhanced method of cost recovery is not practicable (sic) sustainable,' but that is untrue. Using Mr. Gregory's own numbers, the \$32.1 million beyond what qualified for recovery through the GSRS would be recovered through

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<sup>67</sup> Id. at pg. 2, lns 15-22 through pg. 3, lns 1-2.

approximately \$32.2 million in depreciation expense (half of \$64.4 million).”<sup>68</sup>

44. Therefore, CURB recommends “that even if a SIP is approved, the Company should first reach a level of investment in safety-related infrastructure beyond what is recoverable through GSRS and depreciation before recovering additional investment through a SIP surcharge. This would actually result in accelerated pipeline replacement.”<sup>69</sup>

45. CURB recommends that Atmos should first be required to exhaust the millions of dollars it recovers through the GSRS as well as from depreciation before recovering through the SIP. If Atmos does not do so, then they should not be allowed to recover expenses through the SIP for that period.

46. CURB’s third modification to the proposed SIP is that it be limited to the replacement of cast iron or bare steel pipe initially. Atmos currently has estimated 821 miles of steel pipe in the ground in Kansas<sup>70</sup> and continues to discover additional bare steel pipe as they conduct further research.<sup>71</sup> Mr. Frantz largely based this modification from the decision rendered by the Commission in Docket 15-GIMG-343-GIG (Docket 15-343). In that decision, the Commission found that the “accelerated, programmatic replacement of bare steel mains, bare steel service/yard lines, and cast iron mains is in the public interest and necessary, and, therefore, directed the gas utilities to develop a plan for the accelerated replacement of all such pipe.”<sup>72</sup>

47. With the GSRS, the Company will still be able to recover costs related to the replacement of pipe made of materials other than bare steel or cast iron, such as plastic. However, as the SIP is designed to be proactive rather than reactive, its initial scope should be limited to the

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<sup>68</sup> Id. at pg. 11, lns 5-15.

<sup>69</sup> Id. at pg. 11, lns 5-19.

<sup>70</sup> Armstrong Direct Testimony, pg. 2, lns 1-2.

<sup>71</sup> Tr., Vol. 2, pg. 268, lns 1-22.

<sup>72</sup> *Final Order* in Docket No. 15-GIMG-343-GIG (filed September 12, 2017) (15-343 Final Order), pg. 36, ¶78.

replacement of materials which both PHMSA and the Commission have determined pose a higher safety risk.

48. CURB's fourth modification addresses the surcharge and how often it should be updated. Atmos has requested quarterly updates while CURB and Staff have requested annual updates. CURB supports its position of annual updates by, again, looking at the 15-343 docket. In that docket, the Commission determined:

“any program for accelerated replacement of obsolete infrastructure should be structured very similarly to that enacted by the Legislature in the GSRS in order to ensure similar consumer protections granted by the Legislature. The Commission also finds that this approach would be administratively efficient because the Gas Utilities, CURB, and Staff are accustomed to the GSRS process. Therefore, the Commission finds that an annual surcharge best balances the interests of ratepayers and shareholders.”<sup>73</sup>

49. Clearly, the Commission has already decided that an annual surcharge is appropriate for a program for accelerated replacement of obsolete infrastructure. Since the proposed SIP, in any form that it may take, is essentially an accelerated pipeline replacement program, an annual surcharge is appropriate. It is also consistent with how the Commission has ruled in energy efficiency dockets, as pointed out by Staff witness Justin Grady at the hearing:

“The Commission has ruled in other cases like energy efficiency dockets, for instance, that an annual mechanism is timely enough. The Commission is required to allow, ‘timely recovery of energy efficiency costs.’ The Commission had a contested proceeding that I was involved in regarding whether an annual surcharge was, quote, timely and the Commission determined that it was.”<sup>74</sup>

50. In good faith, CURB believes that the contested docket referenced by Mr. Grady was the energy efficiency application filed by Kansas City Power & Light Co. (now Evergy Kansas Metro) in Docket No. 16-KCPE-446-TAR. An annual recovery mechanism is consistent with the annual update process of the GSRS which was supported by Atmos and the other Kansas gas

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<sup>73</sup> Id. at pg. 40-41, ¶85.

<sup>74</sup> Tr., Vol 2, pg. 446, lns 19-25 through pg. 447, ln 1.

utilities. Further, in its SIP, Atmos is proposing to recover a larger investment than the other Kansas gas utilities are through the GSRS with an annual recovery mechanism.

51. Atmos has not posited any need for a more frequent recovery mechanism than an annual one. As Staff witness, Justin Grady testified:

“I have really stretched and looked hard in terms of the timeline that's proposed in the SIP that I have, it's not the same as the GSRS. It's a 40 percent reduction in regulatory lag compared to the GSRS. If you look at Atmos' Annual Reports to its shareholders, they essentially ignore the 6 months that Mr. Smith is referring to. I mean Kansas' GSRS is already in the best category that Atmos reports to its investors. And I'm offering a 40 percent reduction to that. And I just think it's enough, should be enough.”<sup>75</sup>

52. It is more than enough. CURB has opposed surcharges in other dockets (for instance, Docket 15-343) for a number of reasons, including that they undercut traditional ratemaking mechanisms and add confusion to customers' bills. Recognizing that the proposed SIP is confined to safety issues, CURB has lifted its objection so that pipeline replacement will be incentivized by accelerated recovery of investment costs, even though regulatory lag is lessened. The annual recovery mechanism provides a reasonable balance between ratepayers' interests and Atmos' interests. A quarter-annual or even a semi-annual recovery mechanism is too imbalanced towards Atmos. As Mr. Grady notes, an annual recovery mechanism “should be enough.”

53. CURB's fifth modification is a condition that the initial monthly SIP surcharge should be no more than \$0.40 per residential customer per month, and with each annual update, the SIP surcharge should not increase by more than \$0.40 per residential customer per month.<sup>76</sup> Mr. Frantz testified that “establishing a SIP surcharge cap is important to ensure consumer protections similar to those imposed by the Kansas Legislature in the GSRS and the Commission's

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<sup>75</sup> Id. at pg. 444, ln 25 through pg. 445, lns 1-10.

<sup>76</sup> Frantz Direct Testimony, pg. 13, lns 9-16.

ARP [Accelerated Replacement Program].”<sup>77</sup> Unlike Atmos, Mr. Grady also conditioned Staff’s approval of the SIP upon a spending cap. Mr. Grady testified that SIP capital expenditures should be subject to a cap of \$50 million, an average of \$10 million per year.<sup>78</sup>

54. CURB believes that its cap of \$0.40 per residential customer per month is a better limitation than Staff’s cap of \$50 million. In this regard, it is important to note that Atmos conceded during the hearing that it is not likely to spend \$50 million over the five-year program.<sup>79</sup> In fact, Atmos would be satisfied with CURB’s cap.<sup>80</sup> As such, the CURB cap would likely cause Atmos to prioritize SIP spending because it is closer to the actual budget Atmos proposes with respect to pipeline replacement. Additionally, it provides a balance. In Docket 15-343, the Commission observed:

“The Commission has significant concerns about the impact an additional surcharge for accelerated replacement of infrastructure will have on residential customers. Similar to its rationale above regarding reliance upon the wisdom of the Legislature, the Commission finds that a \$0.40 per residential customer per month strikes a prudent balance between overburdening ratepayers and sufficiently incentivizing the Gas Utilities.”<sup>81</sup>

55. In this case, the GSRS has already increased safety related capital expenditures by \$0.80 per month per residential customer. Staff’s proposed increase of the equivalent of \$0.60 per month per residential customer (when not required by Atmos) does not appear to promote as reasonable of a balance between utility needs and customer impact as does CURB’s proposed limitation. It must be remembered that the SIP is merely a pilot program at this point. As Mr. Smith put it:

“So I don’t think we are bothered by the ranges they propose and really don’t have any plans to over shoot that because we want to make -- we believe that all the

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<sup>77</sup> Id. at pg. 13, lns 9-10.

<sup>78</sup> Direct Testimony of Justin T. Grady (Grady Direct Testimony), pg. 6, lns 18-19.

<sup>79</sup> Tr., Vol. 2, pg. 316, lns 8-18.

<sup>80</sup> Ibid.

<sup>81</sup> 15-343 Final Order, pg. 43, ¶89.

parties are generally in agreement that they want to accelerate the current pace of replacement. And we just would like to see a viable pilot where you are approving the projects before we undertake them. You are seeing how we are prioritizing projects. It's going to be much more transparency than GSRS has had or anything that we know of in Kansas. And if it's \$3 million a year, \$5 million a year, it's as much as the experience if we jointly believe it is beneficial and then figure out where we go from there. So the variability in spending was a reference to part of my testimony that was annual model.”<sup>82</sup>

56. In view of this testimony and the observations of the Commission in Docket 15-343 regarding customer impact, it does not make sense to provide a cap that Atmos does not appear to need at this time. Rather, it makes sense to limit the impact to residential consumers as much as possible and use this SIP as a pilot to see how it works. At the end of the five-year program, caps can be adjusted for future years.

57. CURB’s final modification would be the imposition of a three-year rate moratorium before a new rate case could be filed by Atmos. Atmos indicated that it may file fewer rate cases if granted the SIP, but there is no assurance in neither its Application nor in its testimony that Atmos will actually do so.<sup>83</sup> Atmos seems to want all the benefits from the SIP, which it repeatedly indicates is being proposed in part to eliminate the need to file frequent rate cases, but does not want to offer this assurance in any concrete form. If Atmos is granted the SIP, CURB believes Atmos should be subject to a three-year rate moratorium as this would address all parties’ concerns about the frequency of rate case filings.

58. CURB agrees with all parties in this docket that the Commission’s authorization of a SIP for Atmos is appropriate at this time. However, CURB does not support the request by Atmos as it contains too little detail as to how the SIP would be structured and used. Therefore, CURB encourages the Commission to consider its proposed modifications to Atmos’ SIP proposal.

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<sup>82</sup> Tr., Vol. 2, pg. 316, lns 13-25 through pg. 317, lns 1-3.

<sup>83</sup> Tr., Vol. 2, pg. 263, lns 12-17.

## V. Depreciation Rates

59. CURB witness James Garren sponsors direct testimony regarding depreciation in this docket. In the course of his review, he had the opportunity to review testimony from Atmos witness Ned Allis, as well as, review responses to data requests provided by Atmos. He used this information, along with other discovery and his own analysis, to recommend certain adjustments to Atmos' proposed depreciation rates. Based on these reviews, CURB has proposed depreciation expenses that are lower than those proposed by Atmos. These are lower for two basic reasons. First, Mr. Garren has recommended an increase in the service lives of seven distribution accounts. Second, he has proposed that the Commission adopt an alternative method of estimating future net salvage, which is based on the most recent 5-year history of the company's net salvage<sup>84</sup>

60. Mr. Garren takes issue with Mr. Allis' analysis as Mr. Garren believes that Mr. Allis' proposed average service lives vary from historical indications and that his proposed average service life diverges significantly from the statistical indications.<sup>85</sup>

61. CURB issued discovery requests in order to help determine how Mr. Allis developed his recommendations that seemed inconsistent with historical data for the seven accounts for which Mr. Garren had concerns. The response to CURB data request 1-75 states:

“Consistent with authoritative depreciation texts and accepted depreciation practices, there are no FERC accounts for which the proposed survivor curve is based solely on a regression or other statistical analysis. The life and curve selection process for each account is based on informed judgment that considers both mathematical and visual curve matching based on the retirement rate method, as well as other known information concerning the account gathered through interviews with Company personnel, site visits, industry experience, and general knowledge of the equipment in each account. The reason for not relying solely on “best-fitting” curves from the statistical analysis is that the estimation of survivor curves is a process of estimating the future life characteristics for the assets currently in service, and therefore judgment must be incorporated in order to ensure

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<sup>84</sup> Direct Testimony of James Garren (Garren Direct Testimony), pg. 4, lns 10-11.

<sup>85</sup> Id. at pg. 6, lns 19-22.

the most reasonable estimates”<sup>86</sup>

62. Mr. Garren believes that Atmos provided no specific information or insight concerning Mr. Allis’ reasoning for any particular depreciation account. Mr. Garren reviewed the information provided in the data responses, industry statistics, maintenance programs and management expectations, and he did not find any information suggesting that future expectations should diverge significantly from historical information.<sup>87</sup>

63. Mr. Garren describes average service life for a given account as “a projection of the number of years that a new unit of plant can be expected to remain used and useful on average. This concept is useful because modern depreciation analysis utilizes what we call ‘group depreciation.’”<sup>88</sup> He further discusses the use of “group depreciation” as the:

“[depreciation of] the value of a collection of units rather than [depreciation of] the value of an individual unit or units over the lifetime of these units. This group depreciation assumes that many units in each account will be retired at earlier ages, and thus have a shorter than average life, and many units will retire at later ages, and thus have a longer than average life. Average service life is used to calculate the average remaining life, which, in turn, is the denominator in the calculation of depreciation expense. Group depreciation is also why we do not study the lives of units in an account, but rather, the lives of dollars in these accounts. Therefore, all else being equal, a longer average service life directly results in a lower depreciation expense.”<sup>89</sup>

64. Mr. Garren reviewed and analyzed the information in this docket using the Retirement Rate method. He describes this method as:

“an actuarial technique used to study plant lives, much like the actuarial techniques used in the insurance industry to study human lives. It requires a record of the dates of placement (birth) and retirement (death) for each asset unit studied. Retirement data that contains this date of placement and retirement is referred to as ‘aged data’ because it tells the analyst the age of the plant at the time it was retired. The Retirement Rate method is the most sophisticated of the statistical life analysis

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<sup>86</sup> Garren Direct Testimony, pg. 7, lns 4-17.

<sup>87</sup> Ibid at lns 19-24.

<sup>88</sup> Ibid at lns 25-29.

<sup>89</sup> Garren Direct Testimony, pg. 7, ln 30 through pg. 8, lns 1-8.

methods because it relies on the most refined level of data.”<sup>90</sup>

65. Once performed, the Retirement Rate method produces results in the form of an “Iowa Curve.” These Iowa curves are a “surrogate or standardized observed life table based on a specific pattern of retirements around an average service life. ...The curves provide a set of standard patterns of retirement dispersion. Retirement dispersion merely recognizes that accounts are comprised of individual assets or units having different lives.”<sup>91</sup>

66. Mr. Garren further explains that:

“[t]he purpose of Iowa curves is to enable the calculation of an average remaining life. Remaining life calculations take the current age of each vintage within an account and then use the retirement rate projected by the appropriate Iowa curve to project the remaining life of each of these vintages of plant. Ultimately, depreciation accruals for plant investment are calculated from remaining lives, so it is important to select the correct average service life and the correct Iowa curve.”<sup>92</sup>

67. Broadly speaking, Mr. Garren does not have significant concerns with Mr. Allis’ service life analysis, but rather with the extent to which Mr. Allis’ proposed service lives seem to diverge from his life analysis results. Mr. Allis supplies little or no specific explanation for his proposals in all but one account.

68. Mr. Garren critiques the analysis Mr. Allis performed regarding net salvage. Mr. Garren describes Mr. Allis’ methodology as “...a methodology that calculates a ratio of annual net salvage over retirements. Mr. Allis has examined this ratio in five and ten year periods over the past fifteen years. Mr. Allis then exercises his judgment to incorporate the historical data, the age of the plant, managerial expectations, and the experience of other utilities in the industry, and arrives at a net salvage ratio for each account.”<sup>93</sup>

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<sup>90</sup> Id. at pg. 8, lns 17-23.

<sup>91</sup> Id. at pg. 10, lns 2-6.

<sup>92</sup> Id. at pg. 14, lns 4-9.

<sup>93</sup> Id. at pg. 27, lns 14-18.

69. Mr. Garren has significant concerns with Mr. Allis' methodology. He believes it produces unrealistically high net salvage ratios. Net salvage and retirements are not casually related or mathematically correlated in any way and therefore reliance on this ratio yields unreliable and unsound results.<sup>94</sup>

70. Mr. Garren proposes different results from Mr. Allis in seven accounts and recommends that the Commission adopt his adjustments to these seven distribution accounts. CURB will not address each account individually, however, all his recommendations differ from Mr. Allis' and are contained in Mr. Garren's direct testimony.<sup>95</sup>

71. Mr. Garren recommends the Commission adopt an alternative method of estimating future net salvage, which is based on the most recent 5-year history of the company's net salvage. He defines "salvage" as:

"the theoretical value of property after retirement. Net salvage is gross salvage minus cost of removal. Cost of removal is the cost that the Company incurs for the process of retiring plant in service. Gross salvage is the amount that the Company can recoup from its retirements through sales of parts and scrap. Thus, net salvage is the net proceeds and expenses of retiring plant. Because net salvage is considered part of the cost of the investment in plant in service, it is collected as part of depreciation expense to recoup that cost of investment, just as the rest of the Company's investment in plant in service is also recovered through depreciation charges."<sup>96</sup>

72. Further, Mr. Garren states:

"I have estimated total future net salvage by multiplying the annual accrual requirement by the account remaining life. This is a straight-line accrual estimate and approach. I believe that the Company's most recent five years of net salvage data provide the best indication of the appropriate annual accrual for the immediate future. This average should then be updated with each subsequent depreciation study, perhaps in a technical update like the one Mr. Allis has submitted in this proceeding. Accordingly, I propose that the Company calculate its total future net salvage by multiplying its required current annual net salvage accrual based on its most recent five-year average of net salvage for each account by the remaining life

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<sup>94</sup> Id. at pg. 27, lns 20-23.

<sup>95</sup> Id. at pgs. 22-26.

<sup>96</sup> Garren Direct Testimony, pg. 26, lns 11-15.

(i.e., the plant not yet depreciated) for that account. This methodology is superior to the Company’s proposal.”<sup>97</sup>

73. Using his proposed methodology, Mr. Garren calculates the total impact of these adjustments to Atmos’ Depreciation Rate and Expenses for an aggregate amount of (\$2,973,248), as shown in Table JSG-1 below.<sup>98</sup>

**Table JSG-1**  
**Summary of Depreciation Rates and Expenses**  
**Based on September 30, 2018 Plant Balances**

	<u>Atmos Rate</u>	<u>Atmos Expense</u>	<u>CURB Rate</u>	<u>CURB Expense</u>	<u>Adjustment</u>
<b>Storage</b>	3.02%	\$133,694	3.02%	\$195,344	\$61,650
<b>Transmission</b>	4.54%	\$80,584	7.63%	\$135,331	\$54,747
<b>Distribution</b>	3.65%	\$12,754,557	2.76%	\$9,652,919	(\$3,101,638)
<b>General</b>	7.26%	\$762,571	7.37%	\$774,563	(\$12,082)
<b>Total</b>	3.73%	\$13,731,406	2.92%	\$10,758,158	(\$2,973,248)

74. CURB encourages the Commission to review Mr. Garren’s direct testimony detailing his request for the adoption of his proposed methodology, depreciation rates, and adjustments in this docket.

## **VI. Incentive Compensation Adjustment**

75. CURB requests that the Commission disallow 100% of Atmos’ incentive compensation expenses beyond base salary. Andrea Crane sponsors testimony on behalf of CURB in rejecting Atmos’ requests to recover these expenses from ratepayers. These expenses include three different incentive compensation plans that Atmos offers: the Variable Pay Plan (VPP), the Management Incentive Plan (MIP), and the Long-Term Incentive Plan (LTIP). Atmos fails to present sufficient evidence to demonstrate that these expenses are necessary in providing sufficient

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<sup>97</sup> Id. at pg. 34, lns 3-14.

<sup>98</sup> Id. at pg. 5, lns 1-18.

and efficient natural gas service to ratepayers, and therefore, should not be allowed to recover them through rates. Atmos' claim that failure to collect these expenses from ratepayers shall require the end of these plans and lead to a sharp loss of employees at every level is an exaggerated and unreasonable conclusion. Atmos does not do business in Kansas as a result of the free market, but through certification and a commitment to providing a utility service to Kansas residents and businesses. Under Atmos' treatment of these expenses, shareholders are given a free ride for their investments and continually approve excessive benefits for a small number of executives.

76. The VPP/MIP guidelines primarily base the awards on shareholder-focused financial performance that do not benefit ratepayers and should be disallowed from rates. Ms. Crane reviewed the plans' guidelines and discovered that nearly all the performance metrics look only at the Company's earnings and returns on investments to determine eligibility for awards.<sup>99</sup> The description of these plans advertise a focus on shareholder benefits and financial goals.<sup>100</sup> Customer satisfaction appears to be an afterthought for these awards and is factored into decisions made by the Human Resource Committee of the Board in an unknown fashion.<sup>101</sup> The awards themselves are funded only if Earnings per Share (EPS) over the performance period is comparable to Atmos' targeted EPS, as derived from Atmos' annual budgeting process.<sup>102</sup> Thus, no matter the level of employee contribution or customer satisfaction, unless these financial thresholds are met, no award is available for employees.<sup>103</sup>

77. Kansas ratepayers already pay for executive and employee base salaries for the provision of sufficient and efficient utility service but should not be 100% responsible for

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<sup>99</sup> Confidential Direct Testimony of Andrea C. Crane (Crane Confidential Direct), pg. 18, lns. 2-20.

<sup>100</sup> Id. at pg. 19, lns 18-23 through pg. 20, lns 1-13.

<sup>101</sup> Id. at pg. 19 lns 4-5; Rebuttal Testimony of James F. Reda (Reda Testimony) at pg. 10, lns 15-19.

<sup>102</sup> Reda Testimony at pg. 10, lns 12-14.

<sup>103</sup> Crane Confidential Direct, pg. 19, lns 7-17.

additional substantial incentive compensation created by shareholders. Atmos contends that incentive compensation based on financial benchmarks benefits ratepayers and tied to customer satisfaction.<sup>104</sup> Atmos witness James Reda relies on customer surveys regarding satisfaction with service and a regression analysis compared to increased EPS over a number of years. He argues that there is a positive correlation between EPS and overall customer satisfaction percentage from 2015-2019.<sup>105</sup> There are a number of limitations to the weight that this testimony should be given. First, the telephonic surveys had little to do with customers' opinion on EPS or satisfaction with the level of capital expenditures.<sup>106</sup> Mr. Reda's analysis fails to explain the plans' various financial benchmarks and how it translates into the areas of customer satisfaction with positive reviews. Second, the percentage of total customer participation that is included in Mr. Reda's analysis is unknown. Mr. Reda was unable to explain the specifics behind survey participation or why these results would be considered statistically significant in a comparison to EPS.<sup>107</sup> If these bare results are to be attributed to the entire Atmos Kansas Jurisdiction, then equal consideration should be given to the large volume of public comments submitted to the Commission.<sup>108</sup> Concluding that there is a direct link between financial success and customer satisfaction extrapolates well beyond what each data point represents. Third, the groups that benefit most from an increased EPS (shareholders and executives) rarely interact with ratepayers. It is misleading to state that customer satisfaction is derived from the level of incentive compensation paid to a small number of executive members.

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<sup>104</sup> Reda Testimony, pg. 20, lns 4-6.

<sup>105</sup> Id. at pg. 14, lns 7-10.

<sup>106</sup> Tr., Vol. 3, pg. 557, lns 16-25 through pg. 558, lns 1-13.

<sup>107</sup> Id. at pg. 591, lns 5-25 through pg. 592, lns 1-2.

<sup>108</sup> See *Notice of Filing of Public Comments* in Docket No. 19-ATMG-525-RTS (filed on December 18, 2019).

78. Atmos' claim that failure to fund these incentive compensation plans with ratepayer money will result in a significant loss of qualified employees is overstated and does not justify the plans' inclusion in base rates. Ms. Crane points out that a substantial portion of incentive compensation is not being expensed in this item, but rather booked as capitalized overhead allocated to other Kansas rate base components. As a result, ratepayers are likely incurring additional costs through a return on, and return of, incentive compensation costs that have been capitalized.<sup>109</sup> This provides assurance that employees and executives are still receiving incentive compensation funded by ratepayers.

79. Mr. Reda spends a great deal of time emphasizing that shareholders voted overwhelmingly to implement these incentive compensation plans. He noted that 94% of Atmos' shareholders approved the incentive compensation structure in 2018.<sup>110</sup> He states that companies with unfair compensation practices that are divergent from the market do not receive this high level of approval. During the hearing, Mr. Reda testified that this high level of approval exists despite the lack of information on whether shareholders or ratepayers would fund the plans.<sup>111</sup> He testified that shareholders overwhelmingly supported the plans regardless of who is paying for them.<sup>112</sup> Mr. Reda also states that he does not have concerns about Atmos' ability to attract capital with the current management team.<sup>113</sup>

80. Contrast this attitude to Atmos' arguments for including these plans in base rates. Atmos claims that failure to use these types of plans would put Atmos at a competitive disadvantage in hiring qualified employees.<sup>114</sup> This is because other industries use these plans and

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<sup>109</sup> Crane Confidential Direct, pg. 21, lns 18-20 through pg. 22, lns 1-6.

<sup>110</sup> Reda Testimony, pg. 4, lns 7-11.

<sup>111</sup> Tr., Vol. 3, pg. 551, lns 18-25 through pg. 552, lns 1-5.

<sup>112</sup> Id. at pg. 552, lns 22-25 through pg. 553, ln 1.

<sup>113</sup> Tr., Vol. 3, pg. 558, lns 14-17.

<sup>114</sup> Atmos Initial Brief, pg. 26, ¶43.

funded at this level as well.<sup>115</sup> Mr. Reda states that if these plans are disallowed, then Atmos would have to eliminate them entirely, thereby lowering the compensation level of employees.<sup>116</sup> Mr. Reda predicts that this drop in incentive compensation will lead to a loss of talent. However, Mr. Reda did not perform any type of analysis for this loss. He did not survey executives or employees to determine the levels of loss or over what time frame it may occur. He cannot anticipate the loss of capital associated with any type of employee turnover. In fact, Atmos does not even provide an explanation as to why failure to include these plans in base rates leads to the outright elimination of the costs. If shareholders voted 94% to approve these plans to award executives and employees for their financial performance without consideration of who is paying for the awards, it does not follow that these same shareholders would, in turn, vote to remove the plans once shareholders are responsible for them.

81. Shareholders are the ones who directly benefit from financial performance that exceeds expectations in the form of increased returns on investment. Shareholders are likely individuals and groups that are well-educated and financially-savvy. If Atmos is correct in its predictions about the aftermath of the loss of qualified employees, then shareholders would be weary of eliminating the plans at the risk of hurting their returns on investment. Atmos' predictions on the impacts of disallowing incentive compensation in rates are speculative, at best, and do not justify passing 100% of those expenses onto the ratepayers.

82. Atmos makes a number of responses to CURB's and Staff's adjustments for incentive compensation. The first involves a concern that ratepayers not paying for incentive compensation violates the balance of interests test and skews results in favor of the ratepayer over the utility. Atmos argues that incentive compensation is just another operating cost, like plant-in-

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<sup>115</sup> See Reda Testimony at pg. 16, lns 11-17.

<sup>116</sup> Id. at pg. 15, lns 9-12.

service.<sup>117</sup> Atmos asserts that if it must disallow a portion of all operating costs merely because shareholders in some way benefit from incurring those costs, then Atmos would not have the opportunity to recover its expenditures.

83. CURB agrees that such a treatment of *all* operating costs would be unreasonable, however, the topic of incentive compensation is vastly different compared to other operating costs. First, ratepayers are already paying for base salaries and various incentive compensations that are already booked as overhead expenses, as explained above. Second, the context that creates the plans differs from the decisions to build additional plant to provide service to the public. Shareholders, who may never even take service from Atmos, are solely responsible for determining the level of additional compensation. The additional compensation plans are funded primarily based on financial performance and earnings of the company. The amount of regular overhead costs is based on what is necessary to provide service to the customers who demand it, changing based on the number of customers and load volume. Incentive compensation levels vary depending on where the Company falls on an index of a proxy group of other companies. Compensation does not vary with the number of customers demanding service, but instead on aiming to be in the 50<sup>th</sup> percentile of these other companies. This type of analysis accounts for various risk factors and market considerations. Shareholders benefit from this comparison because they are free to choose where to put their money while ratepayers cannot choose to purchase a utility service from a competitor. Mr. Crane highlights that this compensation benchmarking results in an ever-expanding competition to increase benefit levels to avoid falling behind.<sup>118</sup>

84. Atmos' second argument is that there is no evidence to support the notion that customers are receiving insufficient or inefficient service with these incentive compensations in

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<sup>117</sup> Atmos Initial Brief, pg. 28, ¶46.

<sup>118</sup> Crane Confidential Direct, pg. 24, lns 1-12.

place.<sup>119</sup> CURB does not argue that Atmos is failing in its primary purpose to provide service in Kansas. Rather, CURB argues that the evidence does not demonstrate how these particular incentive compensation expenses result in sufficient and efficient service. Mr. Reda attempts to buttress his opinion in support of including incentive compensation by asserting that Atmos' plans fall at or below the 50<sup>th</sup> percentile of a group of proxy companies.<sup>120</sup> This assumes that the group he used to compare Atmos' compensation levels contains gas companies that are well-below and above this median. He did not comment on whether any of these other companies are failing to provide sufficient and efficient service. Atmos did not indicate a trend of these below-median companies suffering from a loss of qualified employees and a subsequent inability to attract capital. It is very likely that these companies are still able to provide reliable service. However, this practice of aiming for the 50<sup>th</sup> percentile among companies creates an ever-expanding competition to raise compensation to stay near 50%. This results in higher costs for customers to keep up with these increases with no discernable benefit to them.<sup>121</sup> There is no direct evidence to connect an increase in compensation to reach the 50<sup>th</sup> percentile with improved service. Therefore, the market levels of compensation do not portray a reasonable connection between incentive compensation levels and sufficient and efficient service.

85. Atmos' third argument is that CURB's view of the incentive compensations plans being tied to one financial metric, EPS, is misplaced because: (1) the costs are reasonable compared to other companies, (2) customer satisfaction is increasing, and (3) customer benefits are considered in the award.<sup>122</sup> Points 1 and 2 are addressed above in this section. Point 3 regarding the consideration of customer benefits is unique in that it is not based upon concrete metrics, but

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<sup>119</sup> Atmos Initial Brief, pg. 29, ¶47.

<sup>120</sup> Reda Testimony, pg. 28, lns 12-17.

<sup>121</sup> Crane Confidential Direct, pg. 24, lns 4-9.

<sup>122</sup> Atmos Initial Brief, pg. 29, ¶48-50.

rather a subjective review by Atmos' Human Resource department. The sole guiding metrics for Atmos' incentive compensation plans are based on EPS and financial performance. Staff witness Kristina Luke-Fry explains in her live testimony that the only consideration of customers' interests is at the distribution level of these plans, based on a subjective review by human resource managers, with no particular performance thresholds.<sup>123</sup>

86. This is a critical difference compared to a case that Atmos cites to justify the reasonableness of the plans. In Docket No. 99-WPEE-818-RTS (Docket 99-818), the Commission approved a variable compensation plan as part of a splitting of traditional cash compensation model.<sup>124</sup> This order references the rebuttal testimony of WestPlains Energy witness Jon Empson. In that docket, the individual goal requirements related to customer benefits and service made up 70 to 90% of the metrics in that variable compensation plan, with financial goals covering the difference.<sup>125</sup> Mr. Empson further described the specific metrics related to customer service, such as safety goals and unit availability.<sup>126</sup> This metric structure is converse to the structure that Atmos has in place. Virtually all of the guidelines and metrics behind Atmos' compensation plans revolve around meeting financial goals, as stated above. These benchmarks do not necessarily result in ratepayer benefits like the plan in the 99-818 docket. Instead, these incentives were designed to enhance shareholder value.<sup>127</sup> Therefore, shareholders should be responsible for funding the additional incentive compensation plans and the Commission should adopt CURB's adjustments to Atmos' request.

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<sup>123</sup> Tr., Vol 3, pg. 649, lns 7-25 through pg. 650, lns 1-12.

<sup>124</sup> *Order on Application* in Docket No. 99-WPEE-818-RTS (filed January 19, 2000), pg. 18, ¶38.

<sup>125</sup> Rebuttal Testimony of Jon R. Empson, Docket No. 99-WPEE-818-RTS (filed October 22, 1999), pg. 3, lns 19-23.

<sup>126</sup> *Id.* at pg. 4, lns 11-22 through pg. 5 lns 1-7.

<sup>127</sup> Crane Confidential Direct, pg. 24, lns 14-21.

## **VII. Construction Works in Progress (“CWIP”)**

87. CURB recommends that the Commission adopt the adjustments to Atmos’ Construction Works in Progress (“CWIP”) expenses as outlined in Schedule ACC-4. Ms. Crane reviewed information contained in Atmos’ initial application and subsequent responses to data requests and eliminated certain inclusions made by Atmos. First, Ms. Crane started with the actual amounts that were booked to CWIP as of the end of the test year, March 31, 2019, and eliminated those not commenced prior to that date.<sup>128</sup> Next, she included the projects that were completed and placed into service within one year, based on project start dates and completion dates provided in response to Staff Data Request 1-26.<sup>129</sup> Finally, Ms. Crane reallocated costs associated with non-project specific accruals with a percentage of project-specific costs as of March 31, 2019. This method was used for Atmos’ Kansas Direct projects and General Office (Division 2) projects.<sup>130</sup> CURB also included all of the Customer Support (Division 12) projects as indicated by Atmos, but excluded all CWIP from the Colorado/Kansas General Office (Division 30).

88. CURB’s adjustments to CWIP include “property” in the meaning of K.S.A. 66-128 and excludes costs that are not “property.” Ms. Crane identifies a number of costs that were included in rate base that should not qualify as property. These include labor accruals and accounts payable that are not project-specific.<sup>131</sup> She determines that a vast majority of the Colorado/Kansas Division CWIP claims involve labor accruals that were allocated to these projects. In addition, the CWIP that is project-specific consists of desks, computers, and other office equipment and Ms. Crane reasoned that these items do not meet the literal definition of “construction works in

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<sup>128</sup> Crane Confidential Direct, pg. 12, lns 20-21; pg. 13, lns 1-2.

<sup>129</sup> Ibid at lns 3-6.

<sup>130</sup> Ibid at lns 7-13.

<sup>131</sup> Crane Confidential Direct, pg. 13, lns. 18-22 through pg. 14, lns 1-8.

progress.”<sup>132</sup> These items do not have a significant construction period that requires use of a CWIP accounting mechanism and should be excluded.

89. K.S.A. 66-128 governs the Commission’s authority to allow the value of property that is used and required to be used in the providing of utility service into rate base. In regards to CWIP, K.S.A. 66-128(b)(1) states that “property of the utility which has not been completed and dedicated to commercial service *shall not* be deemed to be used and required to be used in the utility’s service to the public.” (Emphasis added). This sets the criteria for eligible projects which the Commission may determine the reasonable value to include in rate base. The statute does not mandate the Commission to approve or disallow certain property or projects, but rather, gives the Commission the discretion to include such items.<sup>133</sup> The utility is not entitled to automatic recovery of all property and projects, nor is the Commission required to automatically exclude them.

90. In its brief, Atmos states that CURB’s treatment of CWIP violates K.S.A. 66-128 without providing further analysis.<sup>134</sup> Atmos witness Jennifer Story also provides a similar bare conclusion without explanation. Rather than try to glean a rationale, it is important to note that K.S.A. 66-128 does not entitle Atmos to automatic recovery. Only property that is used and required to be used for the public service may be included in rate base. The only exception to that rule that could apply to a gas company is related to property that “will be commenced and completed in one year or less.”<sup>135</sup> Even if property falls into this exception, the property’s value and inclusion in rate base is still subject to the Commission’s discretion. The plain language of K.S.A. 66-128 does not lend itself to a conclusion that CURB’s adjustments somehow unlawfully disallow certain costs.

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<sup>132</sup> Ibid at Ins. 3-5.

<sup>133</sup> Kansas-Nebraska Natural Gas Co., Inc. v. State Corp. Commission, 4 Kan.App.2d 674, 677 (Kan. App. 1980).

<sup>134</sup> Atmos Initial Brief, pg. 32, ¶54.

<sup>135</sup> K.S.A. 66-128(b)(2)(A).

91. Atmos' updated CWIP attempts to extend the end of the test year by six months in order to capture projects not commenced and completed within one year or less of the test year. Ms. Story's rebuttal includes CWIP balances as of September 30, 2019, and adjustments to reflect projects expected to be completed by February 2020.<sup>136</sup> When asked about this update at evidentiary hearing, Ms. Story stated that Atmos included projects based solely on a projected completion date, regardless of when the project commenced.<sup>137</sup> In doing so, Atmos inserts the phrase "end of the test year" to the exception found in K.S.A. 66-128(b)(2)(A). Additionally, the words "commenced" and "completed" lose meaning if property and projects booked into CWIP did not start within the test year proper. The policy underlying this exception for CWIP is to ensure that the expenditures included in CWIP are more closely associated with test year activity versus other projects that may be undertaken over a multi-year period. Atmos ignores this critical phrasing by including projects that do not start and finish within one year. Atmos' updates effectively extend the test year from the end of March to the end of September to include projects not originally booked by March 31. Including those projects and property placed into service within a year of the end of the test year, but taking longer than one year to complete, should not qualify for the exception. Therefore, CURB's adjustments follow a reasonable interpretation of K.S.A. 66-128 and should be adopted.

### **VIII. Payroll Tax Expenses**

92. CURB recommends that the Commission adopt the adjustment found in Schedule ACC-8 of Ms. Crane's direct testimony. This adjustment results in a reduction to the Company's payroll costs associated with CURB's adjustment made to incentive compensation.<sup>138</sup> The payroll

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<sup>136</sup> Rebuttal Testimony of Jennifer K. Story (Story Rebuttal Testimony), pg. 32, lns 3-6.

<sup>137</sup> Tr., Vol. 2, at pg. 514, lns 19-25 through pg. 515, lns 1-19.

<sup>138</sup> Crane Confidential Direct, pg. 25, lns 15-20.

tax adjustment eliminates taxes associated with the compensation plans as explained above and falls in line with the statutory rates and cap referenced by Atmos in its initial brief.

### **IX. Uncollectable Expenses**

93. CURB recommends that the Commission adopt the adjustments made by Ms. Crane in her Schedule ACC-12. CURB advocates for the use of a pro forma level of uncollectible expenses based on a three-year average ratio of the percentage of net write-offs to total gas revenue from the test year in this docket.<sup>139</sup> In regards to bad debt, these costs vary from year-to-year based on a number of fluctuating factors, such as overall level of customer bills, changes in gas prices, and general economic conditions.<sup>140</sup> Because rate cases look to set rates prospectively, derived from past information, a normalization adjustment that accounts for multiple years is preferable.

94. Ms. Crane calculates an average uncollectible rate based on Atmos' net write-offs to total gas revenues over the last three years. She determines that the average percentage is 0.40%. Additionally, she reviews the actual bad debt operating expenses booked by Atmos over those same three years and finds the average to also be 0.40%. She concludes that actual net write-offs equaled bad debt operating expenses booked by Atmos during that period.<sup>141</sup> This creates the uncollectible rate based on historical data and accounts for the dynamic circumstances surrounding Atmos' uncollectible expenses.

95. Using this average ratio is preferable to Atmos' approach of taking a snapshot of uncollectible expenses from the test year of conditions and customer levels. Ms. Story alludes to adhering to the Kansas Cold Weather rule in her rebuttal testimony and that it complicates making any adjustments to Atmos' recorded expenses.<sup>142</sup> She refers back to Rebuttal Exhibit JKS-5, which

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<sup>139</sup> Id. at pg. 33, lns. 7-9.

<sup>140</sup> Ibid at lns 4-5.

<sup>141</sup> Ibid at lns 11-15.

<sup>142</sup> Story Rebuttal Testimony, pg. 35, lns 20-22.

contains Atmos' policy and procedures with regard to the Kansas Cold Weather Rule. However, she does not expand on this contention or explain why a three-year average net write-off ratios conflicts with the rule and Atmos' accounting. If anything, the variability associated with adherence to Kansas Cold Weather rule is the type of situation that Ms. Crane's method attempts to address. Atmos' conclusion that CURB's adjustment and methodology are unreasonable is not supported by the evidence and past treatment of these expenses does not necessarily preclude the Commission from adopting a different computation method than prior cases.

#### **X. Lobbying Costs and Membership Dues**

96. CURB recommends that the Commission adopt the adjustments found in Schedule ACC-15 of Ms. Crane's direct testimony. Lobbying activities and their costs are not necessary for the provision of safe and adequate utility service.<sup>143</sup> Although Atmos has made adjustments to certain dues and payments, CURB believes it is appropriate to utilize statutory limits for the remaining dues paid to the American Gas Association (AGA).

97. K.S.A. 66-1,206 and its sister statute, K.S.A. 66-101f, grant the Commission authority to disallow up to 50% of "utilities dues, donation, and contributions to charitable, civic and social organizations and entities" for gas and electric utilities, respectively. Atmos contends in its brief that there is no evidence to support a finding that these remaining dues are unreasonable.<sup>144</sup> Atmos appears to rely on a portion of K.S.A. 66-1,206 immediately following the 50% limitation which states, "in addition to disallowing specific dues, donations and contributions which are found unreasonable or inappropriate." Atmos misinterprets these sections as being one and the same. Such a reading would make the wording redundant and give the phrase "in addition" no meaning. The appropriate interpretation of this statute is that the Commission may disallow

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<sup>143</sup> Crane Confidential Direct, pg. 36, lns 25-26.

<sup>144</sup> Atmos Initial Brief, pg. 35-36, ¶65.

specific dues, donation and contributions that are determined to be unreasonable or inappropriate AND that it may adopt a policy to disallow up to 50% of dues, donations and contributions without such a finding. Ms. Crane’s analysis in her direct testimony addresses the statutory 50% cap on disallowing these costs. She explains that these costs tend to promote the interests of shareholders and that ratepayers have their own ability to lobby through the legislative process.<sup>145</sup> These costs have no functional relationship to the provision of gas service, and K.S.A. 66-1,206 strikes a balance between ratepayers’ interest in only paying for costs that relate to providing service and the utility’s interests in promoting their business through community involvement and lobbying. Therefore, the Commission should adopt CURB’s adjustment on this expense.

#### **XI. Supplemental Executive Retirement Plan (“SERP”) Expenses**

98. CURB recommends adjustments to Atmos’ claim for its SERP costs associated with providing a small number of executive officers large sums of money for retirement. Ms. Crane sponsors Schedule ACC-11, which eliminates Atmos’ claim for all of its SERP costs and other non-qualified retirement plan costs. She notes that this adjustment is based on a response to Staff DR 1-67, which does not identify the amount SERP costs that are capitalized, and may be subject to change if any of this claim is later capitalized.<sup>146</sup>

99. SERP and other non-qualified retirement plans do not contribute to the provision of safe and reliable gas service, and ratepayers should not responsible for paying out for retirement benefits solely on the basis that other companies do the same. These retirement plans fall outside of IRS consideration for special taxation and avoid rules and regulations applied to qualified plans.<sup>147</sup> Ms. Crane noted that the accumulated SERP benefits, as found in Atmos’ proxy

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<sup>145</sup> Crane Confidential Direct, pg. 37, lns 1-6.

<sup>146</sup> Id. at pg. 32, lns 19-22.

<sup>147</sup> Crane Confidential Direct, pg. 29, lns 16-22 through pg. 30, lns 1-3.

statement, is over \$39 million for just five people.<sup>148</sup> This is paid in addition to qualified pension benefits that ratepayers are already paying for based on IRS limitations.<sup>149</sup> Like incentive compensation above, these are costs incurred at the behest of shareholders.<sup>150</sup> These costs represent an astounding level of money paid to a limited number of executive members. Atmos fails to demonstrate how this amount of spending relates to the provision of safe and reliable gas service, aside from keeping pace with companies spending equally high levels for these plans. CURB believes if the IRS determines that costs should not qualify for favorable tax treatment (which would then be covered by other taxpayers), then the Commission should similarly determine that the costs should not be recovered from ratepayers and allow the shareholders to reward executives themselves.<sup>151</sup> Therefore, CURB's adjustments should be accepted for this expense.

## **XII. Meals and Entertainment Expenses**

100. CURB's adjustments to remove 50% of Atmos' request for meals and entertainment expenses not deducted from taxes reflect a reasonable balance between ratepayers and shareholders. Ms. Crane sponsors ACC-16 on behalf of CURB to show the adjustments made to Atmos' request. Ms. Crane suggests that the Commission takes note from the IRS's current treatment of business meals and entertainment expenses for deductibility.<sup>152</sup> Specifically, the Tax Cut and Jobs Act of 2017 placed new limits on the tax treatment of both meals and entertainment. Meals are considered 50% deductible while entertainment expenses are not deductible, barring specific exceptions.<sup>153</sup> To that end, Ms. Story testified that Atmos goes through each and every expense report associated with a receipt and removes amounts that might be controversial in

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<sup>148</sup> Id. at pg. 31, lns 17-19.

<sup>149</sup> Id. at pg. 32, lns 6-7.

<sup>150</sup> Id. at pg. 30, lns 7-37 (referring to Atmos' 2018 proxy statement).

<sup>151</sup> Ibid at lns 12-14.

<sup>152</sup> Crane Confidential Direct, pg. 38, lns 7-13.

<sup>153</sup> Tr., Vol. 2, pg. 505, lns 6-18. *See* Notice 2018-76 Expenses for Business Meals Under §274 of the Internal Revenue Code, <https://www.irs.gov/pub/irs-drop/n-18-76.pdf>.

nature.<sup>154</sup> CURB's primary concern is that while these expenses may include items legitimately tied to utility service, they may also include items not tied to such service or may be more lavish than necessary. Rather than expend the efforts arguing about whether a particular meal or drink is appropriate to charge ratepayers, adopting a 50% split between the shareholders and ratepayers creates a policy that balances fairness with the goal of recovering expenses made in the course of business. Therefore, the Commission should adopt CURB's adjustments to Atmos' request for meals and entertainment expenses.

### **XIII. Rate Case Expense Surcharge**

101. CURB recommends that the Commission allow Atmos to collect its reasonable rate case expenses through a three-year normalization of these costs in base rates. Ms. Crane sponsors Schedule ACC-13 to reflect the three-year normalization period. This method has been approved in prior proceedings in Kansas, including Atmos' last base rate case.<sup>155</sup> Also, a three-year normalization is in line with CURB's recommendation of a three-year rate moratorium in the event that Atmos is granted a SIP. This collection timing helps with the goal of filing fewer rate cases by spacing out collection of the last rate case before filing and incurring new rate case charges, which is the goal of all the parties in this docket. Therefore, the Commission should choose to normalize the rate case expenses over three years in base rates.

### **XIV. Residential Rate Design**

102. CURB recommends a decrease of the residential facilities charge (otherwise known as the customer charge) to \$15.00 from its current level of \$18.04 per month. Glenn Watkins sponsors testimony on behalf of CURB and concludes that a \$15.00 charge is sufficient to recover a significant portion of Atmos' overhead expenses, in addition to the various surcharges and riders.

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<sup>154</sup> Tr., Vol. 2, pg. 506, lns 4-21.

<sup>155</sup> Crane Confidential Direct, pg. 34, lns 18-21.

Mr. Watkins supports the notion that customer charges, such as Atmos' facilities charge, should only reflect the costs required to connect and maintain a customer's account.<sup>156</sup>

103. Such expenses include service lines, meters, meter reading, maintaining customer records, and billing. Other overhead costs and distribution mains should not be reflected in the residential facilities charge because such costs represent the initial expenses Atmos incurs to sell natural gas to customers. To that end, Mr. Watkins conducted a direct customer cost analysis for Atmos' Residential customers, as found in Schedule GAW-3. His conclusions from that analysis justify a charge of between \$8.86 and \$9.82, taking into account both CURB's and Atmos' requested cost of capital figures. However, Mr. Watkins recognizes the value of rate stability found in including overhead costs in the facilities charge.<sup>157</sup> In light of the difference between the current charge and his analysis, Mr. Watkins proposed the \$15.00 change to allow Atmos to recover fixed costs while bringing it more in line with what the charge should represent.<sup>158</sup> This is based on considerations of both ratepayers' and the utility's interests.

104. A lower residential facilities charge, when coupled with Atmos' proposed increase in volumetric charges, will send proper price signals to customers and empower them with the choice in how best to conserve energy and moderate usage. Atmos asserts that a lower customer charge will lead to incorrect price signals, subsidization from higher-load customers to lower-load ones, and discourage customers from actively reducing their energy consumption.<sup>159</sup> However, Mr. Watkins' view of these issues revolves around competitive market forces relating to the regulated business. He explains that prices for a commodity are determined through competition to ensure the most efficient allocation of resources. In the context of a regulated monopoly,

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<sup>156</sup> Direct Testimony of Glenn A. Watkins (Watkins Direct Testimony), pg. 37, lns 1-2.

<sup>157</sup> Tr., Vol. 3, pg. 661, lns 16-25, pg. 662, lns 1-23.

<sup>158</sup> Id. at pg. 38, lns 1-6.

<sup>159</sup> Rebuttal Testimony of Paul H. Raab (Raab Rebuttal Testimony) at pg. 17, lns 8-17.

regulation serves as a surrogate for these competitive forces, and thus pricing policy should mirror such competition to the greatest extent possible.<sup>160</sup>

105. Efficient price signals result when prices are equal to marginal costs. In the long run, these costs are variable. In a competitive market, commodity prices are volume-based, even though a company may have a high level of short-run fixed or sunk costs. The sale of the commodity is what recovers these fixed costs.<sup>161</sup> The competitive market looks to cover its marginal costs of production in the pricing of the commodity, including the fixed costs incurred setting up production. With utilities, marginal costs fall into three categories: demand, energy, and customer.<sup>162</sup> Marginal customer costs measure the incremental change in costs resulting from an incremental change in the number of customers. However, this marginal cost pricing addresses efficiency, that is, to prevent excess capacity going unused. Mr. Watkins states that fair and equitable pricing of a regulated monopoly's product should reflect the benefits received for services and goods.<sup>163</sup> For the sale of natural gas and its usage, the level of consumption is the best and most direct indicator of benefits received. Simply put, the more goods and services received by a customer, the more they will pay for it. Volumetric pricing reflects this principle and is a fair method for all involved.

106. Charging a high facilities charge to gain access to natural gas service actually encourages more consumption. Atmos' fixed costs stem almost entirely from the installation of plant and mains. These expenses are incurred for the sole purpose of Atmos' business: to sell natural gas. High fixed charge rate structures promote additional consumption because the price

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<sup>160</sup> Watkins Direct Testimony, pg. 28, lns 2-8.

<sup>161</sup> Ibid at lns 10-18.

<sup>162</sup> Watkins Direct Testimony, pg. 29, lns 14-17.

<sup>163</sup> Id. at pg. 30, lns 11-17.

of incremental consumption is less than what an efficient price structure should be.<sup>164</sup> Mr. Watkins provides an example of this with an explanation of FERC Order 636. In that order, FERC adopted a “Straight Fixed Variable” (“SFV”) pricing method to encourage the use of domestic natural gas by promoting additional gas usage.<sup>165</sup> This mechanism separated the merchant and transportation aspect of pipelines by collecting all fixed costs from the customer and reducing the price of additional consumption. The stated goal of this order was to increase consumption of domestic natural gas to make it more competitive with other fuel sources.<sup>166</sup>

107. Paying a fixed charge to purchase and use natural gas is akin to having a warehouse club (such as Sam’s Club or Costco) membership. The store is built and stocked with products for the purpose of selling the products to customers. People pay for the membership to get access to the products and further pay for the product itself. Typically, purchases at warehouse clubs are not of the impulse variety, but rather, in bulk at a discount compared to stores that do not require a membership. The discount on products is vital to remain competitive with non-membership companies. No matter how much a person buys from the store, the membership charge is the same.

108. However, it follows that not using the membership would be a waste, thus encouraging more purchases by the customer. Here, the higher facilities charge represents a fixed “membership” for natural gas usage. Whether customers use more or less than the system average does not impact this “membership” charge. Customers are more likely to consume more energy to realize the value of this charge. The critical difference between a membership at warehouse clubs and the facilities charge is that the latter exists within a monopoly populated by a captive customer base. This power difference between competitive and regulated markets is an important

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<sup>164</sup> Watkins Direct Testimony, pg. 31, lns 14-18.

<sup>165</sup> Ibid at lns 19-22.

<sup>166</sup> Id. at pg. 32, lns 4-11.

consideration when setting utility prices.<sup>167</sup> The captive customer base cannot choose to shop around for natural gas at competitors to save money. In this docket, Atmos is asking for a higher facilities charge along with an increase in the volumetric charge. This combination exacerbates the conflict ratepayers experience when trying to reduce their bills. Under Atmos' proposal, customers are paying more for access to Atmos' facilities and then paying even more for the product. There is no increase in value to the customer for the higher bills. They are still using the same facilities and the same type of energy.

109. There is no unreasonable subsidization between higher load and lower load customers due to each customer class's use and contribution to volumetric and fixed costs. Higher load customers evenly spread their demand and use of the Company's facilities throughout the year, regardless of weather conditions. Meanwhile, residential heating customers tend to place more demand during the cold weather months.<sup>168</sup> Because higher load customers evenly spread their demands, these customers are less costly to serve (on a per unit of consumption basis) than low load factor customers.<sup>169</sup> Low load customers continually pay a fixed charge for a system that they may only utilize for one-third of the year. Meanwhile, higher load customers rely on the system all year round and pay for the product they use. As illustrated in Mr. Watkins' Tables 7 and 8, Atmos builds a large portion of distribution mains plant investment into the residential facilities charge.<sup>170</sup> This means that even though higher load customers are paying more in their bills for their purchase and use of natural gas, residential customers are, in turn, paying for a majority of the creation and maintenance of the system used to distribute the product. Therefore, it cannot be said that higher load customers are subsidizing low load customers.

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<sup>167</sup> Watkins Direct Testimony, pg. 34, lns 1-11.

<sup>168</sup> Ibid at lns 12-19.

<sup>169</sup> Ibid at lns 20-21.

<sup>170</sup> Id. at pg. 35, lns 20-23; pg. 36, lns 1-20.

110. Atmos' proposal to increase the residential facilities charge alongside the volumetric charge actually adds to the problems of conservation efforts and subsidization that it seeks to mitigate as explained above. Neither Mr. Raab nor any other Atmos witness is able to point to any particular conservation promotion program it is using or that is relying upon their proposed \$22.00 residential facilities charge.<sup>171</sup> It appears that any conservation efforts falls upon the customer to realize those benefits. The higher facilities charge unfairly leaves the customer to choose between environmental concerns and personal financial security. As explained above, customers are less likely to choose to use less energy when they have already paid a sizable portion of their bill for merely being on Atmos' system. Like in the competitive market, each unit of gas sold is used to pay for both fixed and volumetric costs for Atmos. While higher load customers provide a consistent revenue throughout the year in volumetric charges, residential customers provide spikes during the winter months to compensate. Additionally, the vastly larger residential class pays more in fixed charges for service compared to the fewer non-heating customers. At worst, this relationship can be viewed as symbiotic rather than unlawful subsidization. CURB's recommendation for a \$15.00 facilities charge represents a fair and reasonable balance between charging customers for their use of Atmos' system and Atmos' need to recover costs associated with doing business in Kansas; therefore, CURB asks the Commission to adopt this recommendation.

## **XV. Conclusion**

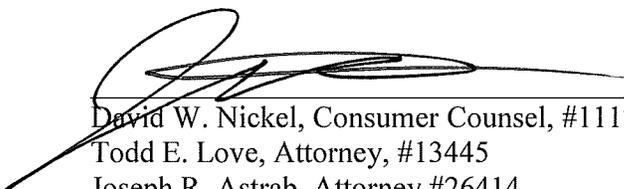
111. WHEREFORE, CURB respectfully requests that the Commission make the above-stated adjustments to the various items that Atmos has asked for inclusion in its rates. CURB also requests that the Commission adopt the above recommendations and modifications for calculation

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<sup>171</sup> Tr., Vol., 3 at pg. 676, lns 22-25 through pg. 678, lns 1-6.

of Atmos' Return on Equity, Capital Structure, and the possible implementation of a System Integrity Program surcharge.

Respectfully submitted,

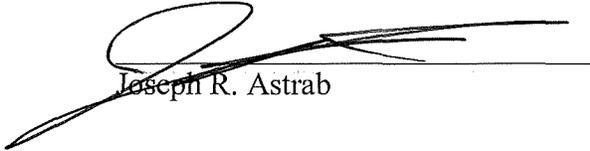
A handwritten signature in black ink, appearing to read 'David W. Nickel', is written over a horizontal line. The signature is fluid and cursive, with a large initial 'D'.

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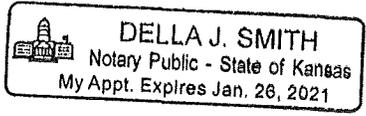
**VERIFICATION**

STATE OF KANSAS                    )  
  )  
COUNTY OF SHAWNEE            )        ss:

I, Joseph R. Astrab, of lawful age and being first duly sworn upon my oath, state that I am an attorney for the Citizens' Utility Ratepayer Board; that I have read and am familiar with the above and foregoing document and attest that the statements therein are true and correct to the best of my knowledge, information, and belief.

  
Joseph R. Astrab

SUBSCRIBED AND SWORN to before me this 15<sup>th</sup> day of January, 2020.

  
DELLA J. SMITH  
Notary Public - State of Kansas  
My Appt. Expires Jan. 26, 2021

  
Notary Public

My Commission expires: 01-26-2021.

**CERTIFICATE OF SERVICE**

19-ATMG-525-RTS

I, the undersigned, hereby certify that a true and correct copy of the above and foregoing document was served by electronic service on this 15<sup>th</sup> day of January, 2020, to the following:

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Della Smith  
Senior Administrative Specialist