THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

In the Matter of the Application of Atmos Energy for Adjustment of its Natural Gas Rates in the State of Kansas.	)))	Docket No. 14-ATMG-320-RTS

CURB'S BRIEF ON CONTESTED ISSUES

I. Return on equity (ROE) should be set at 8.5%, or no higher than 9.0%

A. Introduction and summary

There are only two fundamental questions that the Commission must decide in determining the appropriate Return on Equity (ROE) for Atmos in this case. The first question the Commission must decide is what the appropriate rate of growth is for use in the Discounted Cash Flow (DCF) model. Each of the three witnesses in this case uses similar DCF models, but differ on how each derives the growth rate portion of the model. The differences in growth rates explain the majority of the differences between each witness's ROE recommendations.

CURB maintains that the underlying data and appropriate growth rates suggest an ROE in the range between Dr. Woolridge's 8.5% recommendation and Staff witness Adam Gatewood's 9.0% ROE recommendation. CURB will show that Atmos's witness Dr. Avera uses very selective data as a means of inflating his DCF growth number. To find Dr. Avera's growth results credible, the Commission must suspend economic reality and assume the average investor looks only at five-year earnings growth estimates, and nothing else, when making investment decisions. Not only is this assertion fundamentally naïve, it also violates the basic academic assumption that the DCF model is a long-term growth model. It is also contrary to Commission statements about the use of long-term

nominal Gross Domestic Product (nGDP) forecasts to account for long-term growth in the DCF model.

The second question the Commission must decide is whether it is appropriate to ignore the underlying data and model results and choose a higher ROE number simply because other Commissions in other states have granted higher ROEs. While admittedly the Commission has such discretion, CURB maintains that the data and evidence do not support an ROE in the range Atmos suggests. Recent Commission decisions in Kansas City Power and Light and in Kansas Gas Service indicate ROEs in the lower 9% range; to ignore the evidence and orders in recent Commission cases would be a fundamental disservice to Atmos's ratepayers. While Atmos suggests some nebulous undefined harm will befall Atmos if the Commission does not grant a high ROE, there is no evidence in the record to support this assertion.

While there are many other smaller issues and controversies that can be debated based on the witness testimony in this case, answering the above two questions is fairly straightforward.

B. The models and data support an 8.5% ROE

All witnesses agree that the DFC model is the model favored by this Commission and other Commissions in setting allowed ROE rates for utilities. While each witness calculates and reviews the results of other financial models, it is clear that each witness primarily relies on the results of his or her DCF calculation in forming a recommendation. The DCF model has two basic components, dividend yield and dividend growth--although in this case, the witnesses all utilize other measures of growth in addition to, or as a substitute for, dividend growth.

There is little disagreement among the experts about the dividend yield to be used in the DCF

model. Dr. Woolridge uses 3.7-3.8% in his DCF model. (Woolridge, Dir. T. at 27, Exhibit JRW-10). Mr. Gatewood uses 3.61% to 4.04% in his DCF models. (Gatewood, Dir. T. at Schedule AHG-3). Dr. Avera uses an average of 3.6% in his model. (Avera, Dir. T., Exh. ATO-4 at 1). While there is a slight difference in each dividend yield, on balance the difference of 40 basis points between the top and bottom of the range is not that large. CURB recommends that the Commission use Dr. Woolridge's 3.8% dividend yield in its DCF final result. Dr. Woolridge's 3.8% dividend yield is higher than Dr. Avera's and is the mid-point of Mr. Gatewood's dividend yield recommendation.

There is substantial disagreement over what to use for the dividend growth rate portion of the DCF model. Dr. Woolridge believes that the average investor looks at a wide range of both historic and projected data in forming expectations and in making investment decisions. Therefore, Dr. Woolridge uses a robust mix of historic and forecasted growth rates for dividend yields, earnings and book value in determining the growth forecast for his DCF recommendation. Mr. Gatewood uses short-term analyst earnings growth forecasts, combined with a measure of long-term nGDP growth. Mr. Gatewood recognizes that the DCF model is meant to measure long-term growth, and that a company cannot grow earnings faster than the overall economy grows over an indefinite period of time. Mr. Gatewood mixes short-term earnings growth with long term economic growth to arrive his overall growth rate for his recommendation. The Commission has approved of the use of nGDP as a measure of growth in other cases where the formulation of the DCF model was at issue, and Mr. Gatewood's growth rate formulation is reasonable.

Dr. Avera relies solely on short-term analyst growth rates in formulating his DCF recommendation. Dr. Avera believes that the average investor looks at analysts' 3-5 year earnings growth forecasts, and nothing else, in making investment decisions. His suggestion that investors are

so myopic in their thinking and research is unsupported. Under cross-examination, Dr. Avera admits that he has no evidence to support his contention that investors ignore other information and forecasts. However, relying on such limited information does have the advantage of inflating the DCF model results because short-term analyst earnings growth forecasts are notoriously optimistic. The Commission must reject Dr. Avera's DCF recommendation in this case because it began with a flawed data set, utilizes an overly-inflated growth rate and is based on a premise this is not reasonable or supported by evidence.

Dr. Woolridge recommends an ROE for Atmos of 8.5%. Mr. Gatewood recommends an ROE of 9%, with a range between 8.5% and 9.5%. Dr. Avera recommends an overly-inflated ROE of 10.53%. CURB will show that the evidence supports Dr. Woolridge's recommendation in this case. Further, CURB will show that a close examination of Mr. Gatewood's results indicates he should really be making an ROE recommendation at the lower end of his recommended range. Finally, CURB will show that Dr. Avera's recommendations are simply not supported by evidence, academic theory or common sense.

1. Dr. Avera's proxy group lead to inflated growth forecasts in his DCF model

Dr. Woolridge and Mr. Gatewood used the proxy group of utilities proposed by Dr. Avera in developing their ROE recommendations. The utilities in the proxy group are supposed to have financial profiles that are similar enough to Atmos's financial profile that we can say they represent a proxy for Atmos in financial markets. However, one of the companies in the proxy group is a utility called NiSource, Inc. NiSource is rated BBB- by Standard and Poor's, and rated Ba1 by Moody's Investment services. (Gatewood, Dir.T., Table, at 11). Dr. Avera described a BBB- utility as

"investment grade, but you're at the bottom of your class". (Avera, Tr. Vol. 1 at 55).

Atmos, on the other hand, is rated A- by Standard and Poor's and A2 by Moody's, while the proxy group overall has an average Standard and Poor's rating of A-. When asked if there is a significant difference in risk between a utility with a BBB- security rating and a utility with an A- security rating, Dr. Avera stated that there is a significant difference in financial risk between the two utilities. (*Id.,* at 56). Dr. Avera also acknowledged that NiSource received 54% of its revenue from electric utility operations and that electric utilities are generally considered more risky than natural gas utilities. (*Id.,* at 57). NiSource is clearly an anomaly in this proxy group. Its financial profile does not seem similar to Atmos.

Why is NiSource in the proxy group? It might be because the Value Line 3-5 year earnings growth rate for NiSource is 10.5%, substantially higher than Value Line earnings growth rates of the other utilities in the proxy group. NiSource also has the highest forecasted 3-five-year earnings growth from IBES and Zack's out of the proxy group, with the exception of Atmos's own forecasted earnings growth. If an analyst is looking solely at 3-5 year analyst earnings growth rates, as Dr. Avera does in his DCF model, then including NiSource in the proxy group has the effect of inflating the overall average earnings growth rate of the proxy group.

Dr. Woolridge uses several other measures of growth and does not rely solely on short- term analyst earnings growth rates, so NiSource's extremely high 3-5 year earnings growth forecast is tempered downward by other, more reasonable growth forecasts. For that reason, Dr. Woolridge did not argue strongly to remove NiSource from the proxy group; NiSource does not strongly impact Dr. Woolridge's results. Likewise, since Mr. Gatewood uses an nGDP factor in calculating his growth rates, which also tempers down the impact of NiSource on the overall growth rate in the DCF model,

CURB presumes that Mr. Gatewood also chose not to make an issue of including NiSource in the proxy group. However, the Commission must recognize that examining only short-term forecasted analysts' earnings growth rates, as does Dr. Avera, opens up the opportunity to strategically design a proxy group to get favorable growth results. In this case, adding NiSource, a utility that Dr. Avera describes as substantially riskier than the proxy group—but with extremely high earnings growth rate forecasts-has the effect of inflating Dr. Avera's growth rate and DFC results. The Commission should disregard Dr. Avera's results for this reason.

2. Investors use historical data and other information in forming expectations

Dr. Woolridge uses a far more robust set of analyst information than does Mr. Gatewood or Dr. Avera. Dr. Woolridge reviews both five-year and ten-year historic growth rates in earnings per share, dividends per share and book value per share from Value Line (average growth rate of 4.2%). (Woolridge, Dir. T. Exh.JRW-10, at 3). Dr. Woolridge reviews the projected five-year growth rates in earnings per share, dividends per share and book value per share from Value Line (average growth rate of 5.1%). (*Id.*, at 4). Dr. Woolridge reviews the sustainable growth rate from Value Line (average growth rate of 4.8%). (*Id.,* as updated in CURB Exh. 1). Finally, Dr. Woolridge reviews analysts' projected earnings per share growth rates presented by Yahoo, Zack's and Reuters (average growth rate of 4.9%). (Woolridge, Dir. T., Exh. JRW-10, at 5). All of these growth rates are publically available and commonly used by investors in making investment decisions. Mr. Gatewood testified that it's generally agreed that investors synthesize as much available information as possible in making investment decisions, and pointed out that never before in history has there been so much information available to investors from such a wide range of sources, both public and through

subscriptions. (Gatewood, Tr. Vol. 1, at 195). Similarly, Dr. Woolridge synthesizes similar information and recommends an expected DCF growth rate in the range of 4.5% to 4.75% as reasonable for his proxy group as part of his overall 8.5% ROE recommendation. Dr. Avera uses only analysts' short-term 3-5 year earnings growth forecasts in his DCF model and dismisses Dr. Woolridge's use of historic information entirely. Dr Avera's reliance solely on analysts' short-term earnings forecasts is incorrect for several reasons. First, the DCF model is a long-term growth model. Limiting the DCF time horizon to 3-5 years is simply an incorrect academic approach to the model. Second, Dr. Woolridge provides extensive research to show that it is well-known in the investment community that analyst's short-term earnings projections are overly optimistic. (Woolridge, Dir. T., at App. B). Mr. Gatewood admits that Dr. Woolridge's research caused him to change the way he does his calculations, because he now recognizes "there is clearly a known and a widely known upward bias in analysts' short term growth forecasts". (Gatewood, Tr. Vol. 1, at 205).

On cross-examination, Mr. Gatewood agreed that if you calculate a DCF model and only use analysts' short-term earnings projections, the growth rate in the DCF model could be upwardly biased. (*Id.*, at 206).

Not only is Dr. Avera's formulation of the DFC model incorrect, Dr. Avera simply dismisses historical information that most investors likely use. Dr. Avera suggests that historical conditions are not representative of future conditions for utilities where structural and industry changes have led to declining dividends, earnings pressure and in many cases significant write-offs. (Avera, Dir. T., at 21). Under cross-examination, Dr. Avera could not point to a utility in the proxy group that had suffered from any of these events. Dr. Avera then argues that professional security analysts study historical trends extensively (*Id.*, at 23), but that average investors do not. (Avera, Tr. Vol. 1, at 70).

It defies logic that a professional investor would find value in the study of historic financial information, but that an average investor would ignore this same information. Dr. Avera admitted that the majority of information presented by Value Line is historic and when asked whether it was his testimony that average investors don't have an interest in this historic information, he said "No, it's not my testimony." (Avera, Tr. Vol. 1, at 71). In fact, under cross-examination, Dr. Avera admitted that he had no evidence that average investors ignore historic earnings growth, no evidence that investors ignore historic dividend growth, no evidence that investors ignore historic book-value growth, no evidence that investors ignore projected dividend growth, and no evidence that investors ignore projected book value growth. (Avera, Tr. Vol. 1, at 71-75).

Dr. Avera asks the Commission to put itself in the mind of the investor. Yet Dr. Avera also wants the Commission to believe that the investor mind is so myopic that it only focuses three to five years out, and only cares about one very narrow stream of earnings growth information. Dr. Avera has no evidence to support his assertion that investors ignore the information he chooses to ignore in his DCF model, so the Commission should not rely on his assertion or his ROE results premised on that assertion. By contrast, Dr. Woolridge evaluated a robust set of historical and forecasted financial metrics in determining a reasonable growth forecast in his ROE recommendation, much as does an average investor. The Commission must find that Dr. Woolridge's approach is more representative of how investors use information to make investment decisions, and should accept the 4.5% - 4.75% growth rate in Dr. Woolridge's ROE recommendation.

3. Dr. Avera's short-term growth rates actually support an ROE similar to that of Dr. Woolridge and Mr. Gatewood

Dr. Avera claims that Atmos needs an ROE of 10.53% to satisfy investors. However, a closer examination of Dr. Avera's DCF calculation indicates that an appropriate ROE is in the 8.5 to 9.25% range. First, at Exhibit ATO-4, page 1, Dr. Avera calculates an average dividend yield of 3.6%. Dr. Avera then presents his earnings growth forecasts in Exhibit ATO-4, page 2 of 3. He presents forecasts from Value Line, IBES and Zack's, and also presents a sustainable growth rate forecast. Taking the averages for these growth rate columns, the average Value Line growth rate for the proxy group is 6.5%, the average IBES growth rate for the proxy group is 4.86%, the average Zack's growth rate for the proxy group is 4.9% and the average sustainable growth rate is 6.33%.

It is important that the Commission understand that only IBES and Zack's derive their earnings projections by actually polling professional investors in the market place. So, looking at IBES and Zack's alone, as most representative of a multitude of professional investors' views of the utilities that make up the proxy group, Dr. Avera's information shows that the IBES DCF calculation results in an ROE of 8.46% (3.6% dividend yield + 4.86% earnings growth). Dr. Avera's information shows that the Zack's DCF calculation results in an ROE of 8.50% (3.6% dividend yield + 4.9% earnings growth). Simply put, the two data points from Dr. Avera that are most representative of a broad range of professional investors indicate an ROE in line with Dr. Woolridge's 8.5%.

Value Line creates its own earnings forecast based on a proprietary model. This proprietary forecast may be useful for certain purposes, but it isn't necessarily representative of the market as a whole. In fact, in this case, Value Line's earnings growth forecast is a full 140 basis points more optimistic than the growth forecast of the broad range of professional investors who report to IBES

and Zack's. Some of this difference can be attributed to the effect of including NiSource's 10.5% earnings growth projection in the Value Line earnings calculation. Removing NiSource drops the Value Line average growth rate to 6.05%. The ROE indicated by Value Line is 10.1% (3.6% dividend yield + 6.5% earnings growth), or 9.41% if NiSource is removed. Neither of these comes close to the 10.53% Dr. Avera recommends for Atmos's overall ROE. For reference, the ROE indicated by the sustainable growth rate is 9.93% (3.6% dividend yield + 6.33% earnings growth).

The Commission should be somewhat suspicious of the Value Line and sustainable growth rate ROE indicators, since these two indicators vary so significantly from the IBES and Zack's ROE indicators. But, taking them at face value, if you put all of Dr. Avera's numbers together, the overall DCF indicated by averaging the four separate ROE columns is 9.25%, or 9.1% if NiSource is removed. What this indicates is that, upon closer inspection, Dr. Avera's DCF model produces results very near Dr. Woolridge's recommendation if you just look at IBES and Zack's, and very near Mr. Gatewood's recommendation if you combine all of earning forecasts. This supports the reasonableness of Dr. Woolridge's and Mr. Gatewood's ROE recommendations.

4. nGDP is an appropriate measure of long-term growth

Mr. Gatewood uses a combination of short-term earnings growth forecasts and a long-term nGDP growth rate in his DCF calculation. Mr. Gatewood accords 50% weight to each element. According to Mr. Gatewood, he uses the nGDP figure to account for the long-term nature of the DCF model and to counterbalance some of the known upward bias contained in in the short-term earnings growth forecasts. (Gatewood, Tr. Vol. 1, at 209), Mr. Gatewood develops his nGDP forecast using forecasts published by the Energy Information Administration (EIA) and the Social Security

Administration. (Gatewood, Dir. T., at 40). The Commission found these same sources of long-term growth forecasts appropriate and persuasive in the recent Kansas City Power & Light (KCP&L) rate case. (*See* KCC Docket Number 12-KCPE-764-RTS, *Order,* Dec.13, 2012; *Order on Reconsideration,* Jan. 18, 2013). In addition, the Commission relied primarily on these nGDP forecasts in setting KCP&L's ROE at 9.5%.

The Commission also recently reiterated its support for the use of nGDP forecasts to represent the long-term growth in the DCF model. In the 2013 LaHarpe Telephone Company decision (LaHarpe), the Commission found Mr. Gatewood's testimony "most persuasive and compelling". (*See* KCC Docket Number 12-LHPT-875-AUD, *Order,* June 26, 2013, at 6). In LaHarpe, the Commission specifically found

> Adam Gatewood's inclusion of nominal Gross Domestic Product (nGDP) in his growth rate analysis to be a reasonable and appropriate methodology. Because of volatile short-run earnings growth forecasts, the Commission concludes this consideration of nGDP is helpful to estimate the *long-run growth* for use in the Discounted Cash Flow (DCF) model. Further, it is evident to the Commission that a long-term approach is required by the DCF model because this is how investors value securities in this industry.

(*Id.,* at 7). Further, the Commission dismissed LaHarpe's protests that reliance on nGDP would restrict LaHarpe's access to capital, stating, "because investors typically use a long-term approach to stock valuation, reliance on nGDP cannot fairly be characterized as a "restriction" on LaHarpes's ability to compete for capital." (*Id.*).

If the Commission values consistency in its rulings, and CURB believes that it should, the reasoning of the LaHarpe decision would call for disregarding Dr. Avera's DFC recommendation in this case because it relies only on volatile short-term earnings forecasts, and ignores the long-term growth forecasts that the Commission has identified as integral to the way that investors value

securities. Likewise, this Commission must also dismiss Atmos's objections that Mr. Gatewood's recommended ROE would deny Atmos access to capital. This is simply no evidence in the case to support that assertion.

5. Mr. Gatewood's testimony supports an ROE at the lower end of Staff's range

There are four areas of Mr. Gatewood's testimony, when examined closely, that indicate the Commission should arrive at an ROE in the lower end of Mr. Gatewood's recommended ROE range. First, Mr. Gatewood developed a recommendation based on a Capital Asset Pricing Model (CAPM), putting Atmos's ROE in the range of 7.86% and 8.18%. (Gatewood, Dir. T., at 48). Mr. Gatewood states that he developed these CAPM results by relying on forecasts made by JP Morgan. (Gatewood, Tr. Vol. 1, at 198). While Mr. Gatewood did not use the CAPM results in his final ROE recommendation to the Commission in this case, he does state that the "CAPM confirms the findings of the DCF and IRR [Internal Rate of Return] analysis; capital costs for utilities continue to be low relative to what we observed over the past three decades." (Gatewood, Dir. T., at 48). Under cross-examination, Mr. Gatewood admitted that he often uses the results of the CAPM analysis in making his ROE recommendations, and that had he given the CAPM results a 25% weigh, which is his usual method, "I would be moving down from 9 percent, yes, toward the low end of my range." (Gatewood, Tr. Vol. 1, at 201).

Second, Mr. Gatewood also developed a recommendation based on an Internal Rate of Return calculation (IRR) putting Atmos's ROE at a mean of 8.6% and a median of 8.56%. Under cross-examination, Mr. Gatewood agreed that his IRR result indicates an ROE result in line with the 8.5% recommendation of Dr. Woolridge. (*Id.*, at 203-04).

Third, Mr. Gatewood indicates that "if Atmos is viewed as less risky than the proxy group" then the allowed return would be closer to the lower end of his reasonable range. (Gatewood, Dir. T., at 5). According to Value Line's safety ratings, which use several general financial metrics to rank a company's overall financial safety compared with its peer group, the average safety rating for the proxy group of utilities in this case is a "2". (Avera, Dir. T., at 16). According to the June 14, 2014 Value Line update, Atmos now has a "1" safety rating. (Avera, Tr. Vol. 1, at 61). By this measure, Atmos is regarded as less financially risky than the proxy group. On cross-examination, Mr, Gatewood agreed that the average investor, looking at Value Line, is going to conclude that Atmos is safer than the proxy group. (Gatewood, Tr. Vol. 1, at 215). Even Dr. Avera agreed that Atmos was less risky than the proxy group based on this metric. (Avera, Tr. Vol. 1, at 61). The Commission must conclude from this testimony that Atmos is less financially risky than the proxy group and, following Mr. Gatewood's advice, set an ROE near the lower end of his reasonable range. Again, this would be an ROE near the 8.5% recommended by Dr. Woolridge.

Fourth, Mr. Gatewood states that, "if the Commission believes the long-run nGDP forecast is a better indicator of growth expectations for the natural gas utility industry and Atmos, it should select an allowed return toward the lower end of Staff's range the Commission decisions in KCP&L and LaHarpe reflect that the Commission believes that the long-run nGDP is indicative of an appropriate level of growth for the DCF model. Under cross-examination, Mr. Gatewood agreed that, if the Commission used his nGDP forecast for 100% of the growth in the DCF model, rather than at the 50% level Mr. Gatewood uses, his ROE recommendation would be 8.5%. (Gatewood, Tr. Vol.1, at 211). Mr. Gatewood also offered that this formulation, dividend yield and a growth rate for the broad economy is the methodology JP Morgan uses to establish its view of a return on the broad

equity markets. (*Id.*).

In each instance above, Mr. Gatewood's analysis, together with his admissions under cross-examination indicate that the Commission should set an ROE at the lower end of his recommended range. The lower end of Mr. Gatewood's recommend ROE range is 8.5%, in line with Dr. Woolridge's recommendations in this case. Mr. Gatewood reiterated that CURB and Staff are relatively close in terms of recommendations, and that he does not believe he is close at all to Atmos's recommendations. (*Id.*).

6. Summary of the recommendations based on models

In this case, it is clear that the all the evidence indicates an ROE at the lower end of Mr. Gatewood's recommended ROE range. If the Commission does not want to go that low, an ROE at Mr. Gatewood's 9.0% level would be considered generous. An ROE at this level is consistent with past Commission precedent setting forth how the Commission believes the growth rate in the DFC model should be calculated. This level of ROE is also fair to Atmos. What should also be clear is that Dr. Avera's growth rates and DCF recommendations, based solely on short-term analyst earning growth forecasts, are not consistent with the intended purpose of the DFC model, and not consistent with how investors evaluate long-term growth in stocks. Importantly, they are not consistent with past Commission findings that stress the importance of nGDP growth as a measure long-term growth in the DCF model. Dr. Avera's recommendation should be dismissed outright.

C. The Commission should not set Atmos's ROE based on ROEs in other states

Atmos argues that Dr. Woolridge's and Mr. Gatewood's recommendations are simply too

low when compared to other ROEs allowed by other Commissions in other states. Atmos asks the Commission to simply ignore all of the persuasive evidence above and set an ROE near 10%. Since every percentage point in ROE above that supported by the underlying evidence takes money from utility customers and simply transfers that money to utility shareholders, the Commission should not accede to Atmos's wishes and ignore the evidence in this case. To the extent that other states have allowed returns higher than the recommendations in this case, CURB suggests that the Commission follow the advice of the Kentucky Public Utility Commission. The Kentucky PUC states that "this Commission does not rely on the terms awarded in other states in determining the appropriate ROE for Kentucky jurisdictional utilities." (Exh. Atmos 1, at 29). However, if the Commission decides to consider any other evidence beyond the analyses offered by the financial witnesses in this case, it should consider only the commensurate returns allowed in Kansas for other Kansas utilities.

The Commission granted KCP&L a 9.5% ROE in its last rate case. KCP&L issued similar dire warnings of impending financial disaster that Atmos repeats in this case. KCP&L made the same arguments against the use of nGDP in setting growth that Atmos now makes. KCP&L made the same arguments urging the Commission to ignore the underlying DCF evidence in the case and urged the Commission to set rates based on what had been allowed in other states. It must be noted that, contrary to the dire warnings issued, the sky has not fallen on KCP&L, investors have not abandoned KCP&L, KCP&L stock prices did not hit bottom, capital markets are open to KCP&L and KCP&L is finishing a $1.2 billion retrofit on the LaCygne coal plant. The Commission-allowed 9.5% ROE was clearly just and reasonable for KCP&L and KCP&L continues to have access to capital in the markets.

As noted in the Direct Testimony of Justin Grady in this case, Kansas Gas Service Company

(KGS) reported that it believes in its most recent rate case before the Commission, the settlement agreement provided the company an ROE of 9.2%. (*See* Grady, Dir. T., at 18, FN 10, referencing the *Direct Testimony of Justin Grady,* KCC Docket 14-KGSG-100-MIS, wherein an attached data request response for Kansas Gas Service indicates that, while there was no ROE specifically stated in the rate case, KGS believes it received an ROE of 9.2%). The settlement and the Commission's order did not specify the ROE, but KGS made this admission in a data request response issued in another docket. Presuming that KGS is correct, this ROE of 9.2% is in line with Mr. Gatewood's recommendation in this case for Atmos.

The Commission must also recognize that KCP&L is an electric utility, which Dr. Avera agrees is a generally riskier industry than natural gas distribution. KCP&L is also a BBB rated utility by Standard and Poor's which indicates it has a riskier financial condition than Atmos. Placing KCP&L side-by-side with Atmos, if the Commission believes that 9.5% is an appropriate ROE to compensate KCP&L investors, then logic dictates that something considerably less than 9.5% is appropriate to compensate Atmos's investors given the low level of financial risk faced by Atmos, as indicated by Atmos's A- Standard and Poor rating and number "1"financial safety rating from Value Line. The Commission must arrive at an ROE for Atmos substantially below KCP&L's 9.5% in this case. And if KCP&L has access to capital at 9.5%, Atmos will certainly have access to capital at a lower ROE. Atmos argues in its brief that interest rates were low when the Commission issued the KCPL decision, suggesting that higher current interest rates should lead to an ROE for Atmos higher than KCP&L. (*Brief of Atmos Energy*, at 40). Atmos is wrong for two reasons. First, interest rates are still extremely low. According to Dr. Woolridge, at the time of the Atmos trial, the 30-year Treasury note was at 3.38%. As of this brief writing, rates are 3.29%. At the time of KCP&L's last

rate case, the 30-year Treasury note was floating around 3.0%. There is not a substantial difference in interest rates between then and now, and even if interest rates are slightly higher now, it is not enough of a difference to overcome the overall difference in risk profile between KCP&L and Atmos. Second, for Atmos's argument to be correct, there must be a linear relationship between interest rates and Commission allowed ROEs. While interest rates and Commission- allowed ROEs tend to move in the same direction, Commission-allowed ROEs have not moved down as fast or as far as interest rates have moved down. There is no linear relationship when interest rates are moving down, and there's no evidence to suggest that there should be a linear relationship if interest rates are moving up. There is no reason that Atmos should expect that the Commission will increase its allowed ROE simply because the 30-year Treasury moved up a few basis points.

The Commission must also consider the fairness to KGS, the other major natural gas utility in Kansas. If KGS merits a 9.2% ROE, it would be arbitrary and capricious for the Commission to come up with a higher ROE level for Atmos. There is not enough difference between KGS and Atmos in terms of operations or financial risk to support an ROE above 9.2%.

Ultimately, if the Commission chooses to diverge from the underlying DFC models used above, the Commission should approve an allowed ROE that relates to the Commission's recent decisions on the ROEs allowed for KCP&L and KGS. Logically, given its level of risk, Atmos's allowed ROE should be substantially less than the ROE the Commission allowed for the much-riskier KCP&L, and should be no higher than the 9.2% allowed KGS.

D. Conclusion

The Commission must set Atmos's allowed ROE commensurate with the underlying

evidence and principles set forth above. Dr. Woolridge's recommendation of 8.5% ROE and the recommendation from Mr. Gatewood of 9.0% ROE most closely follow the economic foundation of the DCF model and incorporate those elements this Commission has deemed most important in calculating an allowed ROE. The recommendations of Dr. Avera should be dismissed as inconsistent with the evidence as well as the reasoning of recent Commission orders expressing its preferences. Further, while CURB does not think it is appropriate, as Atmos suggests, to diverge from the underlying DFC model to set an allowed ROE for Atmos based on ROEs allowed to other utilities, if it chooses to do so, CURB recommends that the Commission relate its decision on ROE to the recent Commission decisions in the KCP&L and KGS cases.

II. The Commission should deny the company's proposal to implement a regulatory asset mechanism for recovery of system integrity improvements

A. The company's proposal

The company's proposal is to implement a regulatory asset (RA) mechanism that will allow it to preserve its claims for recovery of costs of system integrity improvements completed between rate cases. The RA tariff provides that the company may record interest on the balance in the regulatory asset account on the pre-tax cost of capital last approved for the utility until it is included in and recovered through base rates in the company's next rate case. (Crane, Dir. T., at 43). The company claims that it does not intend to include revenue-producing projects in the RA, but the tariff, as worded, would not preclude the company from doing so. *(Id.).*

B. Applicable law

1. General provisions

A public utility must seek Commission approval of "any changed rate, joint rate, toll, charge or classification or schedule of charges, or any rule or regulation or practice pertaining to the service or rates of such public utility." K.S.A. 66-117(a). The regulatory asset mechanism proposed by Atmos is a new tariff schedule requiring approval under K.S.A. 66-117(a).

The Commission's order must reflect that it considered all of the evidence in the record in making its findings of fact. Legislative revisions to K.S.A. 77–621(d) in 2009 overturned many years of case law holding that so long as there is evidence in the record supporting the agency's determination, a reviewing court may not substitute its judgment for that of the agency. The current standard is described in a recent opinion of the Kansas Court of Appeals:

> K.S.A.2012 Supp. 77–621(c)(7) has always provided that appellate courts review an agency's factual findings to ensure substantial evidence supports them "in light of the record as a whole." However, as amended, K.S.A.2012 Supp. 77–621(d) now defines "in light of the record as a whole" to include evidence that both supports and detracts from an agency's finding. Thus, appellate courts must determine whether the evidence supporting the agency's factual findings is substantial when considered in light of all the evidence. Substantial evidence is such evidence as a reasonable person might accept as being sufficient to support a conclusion.

[*Clawson v. State Dept. of Agriculture, Div. of Water Resources*, 49 Kan.App.2d 789, Syl. ¶5 (2013)]. The latitude allowed the Commission in weighing the facts has limits. "Not only must an agency's decreed result be within the scope of its lawful authority, but also the process by which it reaches that result must be logical and rational." [*Home Telephone Co. v. Kansas Corporation Comm'n*, 31 K.App.2d 1002, 1012 (2003), citing *Allentown Mack Sales Service, Inc. v. NLRB,* 522

U.S. 359, 374, 139 L.Ed. 2d 797, 188 S.Ct. 818 (1998)]. "The KCC may not arbitrarily disallow an actual, existing expense incurred during a test year. However, claims for future expenses which are merely conjectural are not generally allowed unless the claims are based on known and measurable post-test year changes." [*Columbus Telephone v. Kansas Corporation Comm'n*, 31 Kan.App.2d 828, 834 (2003), citing *Kansas Gas Service v. Kansas Corporation Comm'n*, 4 Kan App 2d 623, 635 (1980)]. This court has stated,

> The Kansas Corporation Commission is obligated to consider competing policies of what expenses should be considered in rate-making decisions . . . .
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> ***
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> . . . . In establishing rates, the Kansas Corporation Commission is required to balance the public need for adequate, efficient, and reasonable service with the public utility's need for sufficient revenue to meet the cost of furnishing service and to earn a reasonable profit.

(*Columbus Telephone Co.*, 4 Kan. App. 2d at 836). Thus, the Commission cannot arbitrarily decide that it prefers one party's position over another's—there must be logic and rationality in its decision-making process, there must be a balancing of competing interests, and most of all, there must be substantial and competent evidence supporting the decision it makes, in light of the record as a whole. Kansas requires that the Commission balance the interest of the utilities, the ratepayers and the public in establishing rates and terms of service.

2. Gas System Reliability Act

With the Gas System Reliability Act, the Kansas Legislature created a surcharge that allows recovery between rate cases for certain kinds of non-revenue producing system replacements, such as the costs of moving mains for public works projects and meeting safety and reliability regulations.

(K.S.A. 66-2201 *et seq.*) There is no Kansas law or case law addressing whether a utility may implement its own infrastructure replacement mechanism in addition to or in lieu of utilizing the Gas Safety and Reliability Surcharge (GSRS) mechanism that was approved by the Kansas Legislature. While the GSRS statute does not provide that the GSRS is the exclusive means by which a natural gas utility may recover its annual costs of replacing infrastructure to ensure safety and reliability, the limitations placed on the amounts that can be recovered annually through the GSRS surcharge imply that the legislature intended only to provide the utilities a limited amount of relief from regulatory lag, not to eliminate regulatory lag entirely. For example, recovery from customer rates is limited to a maximum of 40 cents per month per year. [K.S.A. 66-2204(e)(1)]. Other limitations—the requirement that the utility utilizing a GSRS file base rate applications at least every five years—six with an extension approved by the KCC—indicate the legislature's intention to ensure periodic thorough review of the surcharge costs. [K.S.A. 66-2203(c) and (d)]. It is not clear whether the legislature intended for a utility to devise a different or additional method of recovering its costs of infrastructure improvements made for safety and reliability purposes. However, the general idea behind the GSRS was to reduce regulatory lag on recovery between rate cases of costs of projects that the company could not plan for—such as the costs of moving mains for public works projects, or making emergency repairs to ensure the public safety. [K.S.A. 66-2202(f)]. The GSRS does not appear to have been intended to be the means of recovery of the costs of long-term projects or routine repair and maintenance of utility infrastructure.

The Commission, however, has expressed its opinion that the GSRS is the legislature's preferred mechanism for recovery of infrastructure replacements between rate cases. The most recent order of the Commission addressing whether a natural gas utility should be allowed to

implement an additional surcharge to that of the GSRS for purposes of replacing aging infrastructure was issued in Docket 12-KGSG-721-TAR. In that docket, Kansas Gas Service applied for approval of an "Infrastructure Replacement Program Surcharge" to recover the costs of an eight-year, $70 million program to replace aging cast-iron pipe in KGS's system. Although no one disputed that the cast-iron pipe at issue was prone to corrosion over time and would need replacement at some point, the Commission found that KGS did not identify any benefit that would accrue to the public by accelerating the company's current rate of replacement. *Order Denying Kansas Gas Service's Application for Infrastructure Replacement Program Surcharge*, at 6. The order found, "The Commission continues to find infrastructure replacement should be a priority, and KGS should commit to replace cast iron as quickly as feasible." (*Id.*, at 7). While the Commission commended KGS for having an infrastructure replacement program in place, the Commission concluded that "the cost should be recovered through the legislatively-approved GSRS mechanism." (*Id.*). The Commission went on to state, "As noted by the parties, the GSRS was enacted by the legislature to reduce regulatory lag and allow cost-recovery between rate cases. At this time, the Commission does not wish to eschew the legislature's preferred mechanism for this situation." (*Id.*).

C. The Commission should deny the RA mechanism proposal, because:

1. In enacting the GSRS, the legislature responded to natural gas utilities' requests for relief from regulatory lag in recovering the costs of system integrity improvements. The limited scope of the GSRS represents the extent to which the legislature intended to provide such relief. Atmos should not be permitted to create its own mechanism that provides more relief from regulatory lag than the legislature intended to provide.

The proposal of Atmos for a regulatory asset mechanism to recover the costs of replacing bare steel and other outdated pipes in its system is similar in scope and purpose to that of Kansas Gas Service's proposal to replace cast-iron pipes. Both proposals involve reducing regulatory lag in recovery of the costs of routine replacements of aging pipe. Both companies assured the Commission that there was no imminent danger to safety or reliability. Both companies alleged that the pace of replacements could be accelerated if the Commission agreed to reduce regulatory lag. Neither company claimed that the acceleration would improve public safety and reliability, nor claimed that system reliability would be threatened or harmed without the proposed mechanisms. Neither company claimed difficulty in obtaining financing for the infrastructure replacements. Their sole reason for requesting these mechanisms was to reduce regulatory lag in recovery of the costs.

The main difference in the KGS case and this case is that KGS proposed the recovery mechanism for a specific plan for certain types of system replacement (cast-iron), a timeframe for completion of the projects (eight years), and with a proposed budget ($70 million). While commending KGS for having a plan in place to address system integrity replacements, the Commission rejected KGS's request for the recovery mechanism. The Commission has even fewer reasons to consider granting Atmos's application in this case.

In Atmos's application, the company did not propose a specific plan of replacements or propose a time frame for completion. Atmos added some descriptive information in its rebuttal testimony about the kind of infrastructure it intends to replace, but it lacked the specificity and coherence that would permit anyone to regard it as a "plan". As the KCC's head of pipeline safety noted, the only clear aspect of Atmos's "plan" was "they need to have a mechanism to incent them to spend money to replace aging pipe." (Haynos, Tr. Vol. 2, at 418). The company readily admits that

the RA mechanism proposal is primarily aimed at improving the odds of the Kansas division doing better in the intra-company competition for funds among Atmos's several utility divisions. (Armstrong, Tr. Vol. 2, at 279). Such competition is the method used by Atmos corporate management to allocate discretionary funds that could be used to replace infrastructure, and the winners in the competition are the utility divisions in states that provide the most shareholder-friendly policies. (*Id.*) So the only "plan" to be considered by the Commission for approval is whether to provide shareholder incentives to Atmos in exchange for a vague assurance that doing so would improve the odds that the Kansas division would be allocated more money that could be devoted to infrastructure replacements.

Following the logic of its decision in the KGS case, the Commission will reject this so-called "plan" to create an additional mechanism to recover infrastructure replacement costs between rate cases. The Commission should find that "the GSRS was enacted by the legislature to reduce regulatory lag and allow cost-recovery between rate cases. At this time, the Commission does not wish to eschew the legislature's preferred mechanism for this situation." (*Order Denying Kansas Gas Service's Application for Infrastructure Replacement Program Surcharge*, at 6). While there are other reasons to deny approval of the proposed RA mechanism, the fact that the legislature has already provided a prescribed amount of relief from regulatory lag via the GSRS is a logical reason to disapprove of a utility devising its own mechanism that provides more relief than the legislature intended to provide.

2. Even if the Commission finds that the legislature did not intend for the GSRS to be the exclusive mechanism for relief of regulatory lag for system integrity improvements, there's

no evidence that the RA mechanism would enhance system integrity. The RA mechanism is designed to meet corporate goals of Atmos to provide maximum benefits to shareholders rather than to address the problem of aging and corroding pipes in Atmos's Kansas territory.

The company's primary purpose in proposing the RA mechanism is to provide shareholder incentives. There is no evidence that the company needs the mechanism for financial reasons. When asked whether Atmos lacked the financial resources to upgrade its aging system, Mr. Armstrong described a competition for funds within Atmos among its various utility divisions:

> There are a limited number of dollars, that is correct. We are going to operate safely. We are going to be in compliance. Above and beyond that, there are some discretionary funds, but they are limited. And I'm sitting down with my counterparts, and they have got something similar to a reg asset. Or they have got a mechanism that eliminates this lag issue, and that's a problem for us. When I am sitting with my counterparts and ask for these type of dollars invested in Kansas, we are not at the table. We are not at the front of that line.

(Armstrong, Tr. Vol. 2, at 279).

He further elaborated,

> If we're sittin', all things being equal, operating our system safely, we're operating in compliance. And I'm sitting with my counterparts at budget time of year, and we all have our list of projects that we would like to do. Six of the eight are better off than Kansas. If you're taking a dollar and you're going to invest it somewhere, six of the eight of my counterparts have something more attractive to invest in their state to address these proactive and accelerating this pipe replacement in Kansas today.

(Id.). In other words, each division of Atmos is allocated enough money to ensure compliance with safety regulations, but beyond that, the Atmos corporate hierarchy allocates the company's discretionary funds to its various utility divisions on the basis of which jurisdiction has the most shareholder-friendly policies. Without the RA mechanism, the argument goes, Kansas will not be "at the table" when the funds are handed out.

Although the company's witnesses declined to predict the probable affect that losing the competition for discretionary funds would have on Kansas, they implied that the states with fewer shareholder-friendly policies would be receiving a lesser share of safety and reliability than the others. However, the only assurance provided was that the odds would improve that Atmos's Kansas division would be allocated additional discretionary funds. That's hardly the sort of assurance that would support a reasonable expectation that adopting the RA mechanism will enable an enhanced level of infrastructure replacements in Atmos's Kansas division.

A key question, then, is whether reducing shareholder risk, in and of itself, should be a goal of regulators. Ms. Crane testified that investors should face some risk if they are earning a return on their investment that is greater than the risk-free rate. (*Id.*, at 350). She noted that in addition to providing relief from regulatory lag, the proposed RA mechanism would also allow investors to recover for taxes that the company doesn't even have to pay. (*Id.*, at 351). These are key concessions—to be supported by customer rates—for a mere chance that providing these perks will result in Kansans enjoying reduced risk of aging pipe failures. One should regard this mechanism as primarily intended to reduce risk to shareholders, rather than a mechanism that would reduce risk to customers and the public.

Further, Atmos's practice of using shareholder perks to allocate safety and reliability to its various utility divisions should be troubling to regulators. Regardless of the mechanism utilized to recover costs, ratepayers contribute the costs of ensuring safety and reliability as well as providing the returns that attract shareholders. By definition, the rate of return granted a utility is fair and reasonable. In exchange for a monopoly franchise, a fundamental obligation of all natural gas utilities is to maintain safety and reliability and keep the risk of public harm to a minimum. It is the utility's

responsibility to operate in a manner that enables it to meet all of its safety and reliability obligations once the rates are set. When the ratepayers are providing reasonable rates of return to utilities, they should not have to provide additional shareholder incentives to be assured of their fair share of safety and reliability.

The Commission may presume from the evidence that the company's application is not intended to help Atmos meet pipeline safety standards. Atmos did not offer the testimony of anyone purporting to be a pipeline safety expert, so the company did not offer any testimony on the specific condition of Atmos' infrastructure, the probable costs of replacing its corroding infrastructure, or offer any opinion on the probable impact on the level of risk to public safety if the regulatory asset is not approved. However, all Atmos witnesses asserted that Atmos system is safe, reliable and compliant with all pipeline safety requirements, and the Staff's pipeline safety expert agreed. The question is whether the RA mechanism will help Atmos achieve anything more than provide more benefits to shareholders.

Andrea Crane, CURB's witness on this issue, testified that she found no evidence that Atmos faces any barriers to obtaining the necessary funds for maintaining safety and reliability. (Crane, Tr. Vol. 2, at 347-48). She noted that she was familiar with many of the special programs around the country that Atmos identified as being similar to the proposed RA mechanism; she said, in her experience, such programs were most often approved in response to a utility's inability to finance a specific project. (*Id.*, at 348). No one testifying for Atmos claimed that the company needed the mechanism to finance a program to address its aging infrastructure. Atmos offered no testimony that the company is struggling to maintain adequate cash flow, to obtain suitable financing or to attract investors.

There is no evidence that the RA mechanism will result in increased funding for safety and reliability replacements, or that it will result in reduced risk of serious incidents that are caused by corroding pipes. The company presented absolutely no evidence that the corporate heads of Atmos would choose to allocate more funds for improving aging infrastructure to Kansas if the mechanism is approved by the Commission—and increasing the odds of receiving more money is a long way from actually getting it. Further, there is no evidence in the record that Atmos divisions in more shareholder-friendly jurisdictions enjoy greater safety and reliability than the Kansas division does, or that the utilities in those areas are experiencing fewer incidents caused by corrosion than in Atmos's Kansas division. So there is no evidence that Atmos' other utilities provide a greater margin of safety to their customers and the public as a result of operating in jurisdictions with more shareholder-friendly policies.

As noted above, a major problem with Atmos's application is that it offered very little information about the problem that the RA mechanism is ostensibly designed to address. Without a clear picture of the extent of the problem and the risks involved, it is simply not clear that providing more shareholder incentives is necessary to address the problem or that doing so will make it easier to address the problem—especially without some sort of guarantee that providing the requested incentives will not just improve the odds of receiving more funds for infrastructure replacements, but will actually secure a commitment from Atmos that the Kansas division would receive a specified increase in such spending.

Regulators should first ascertain that there is a problem that needs to be addressed before agreeing to approve a solution. A more realistic and detailed assessment of the actual risks involved would greatly assist regulators and consumer advocates in determining whether accelerating

replacements will meaningfully lower such risks, and whether the costs are reasonable in proportion to the risks. For example, during the twenty-year period from 1994-2013, statistics indicate that major natural gas incidents caused by corrosion (39 total incidents) caused roughly $2.5 million in property damages nationwide. (CURB Exh. 8). Staff's proposal is that Atmos spend $6 million per year in Kansas to address its system infrastructure improvements, over and above what it is recovering through the GSRS, but admits that it isn't sure if that's the right amount to spend. (Grady, Tr. Vol. 2, at 375). It may be the right amount to spend, but on the face of it, $6 million in replacements per year seems out of proportion to the $2.5 million in damages that corrosion caused over a twenty-year period. If we had more and better information, spending $2.5 million per year might seem more reasonable.

In all fairness, there were also nine fatalities during that twenty-year period, which is a much more sobering statistic and a great cost to the public that is much harder to put a value on, but we still have no idea to what extent $6 million a year will mitigate the risks of fatalities. Is the goal to reduce fatalities by 50%? 75%? What is the goal regarding the reduction of property damages? There are no goals, as far as the evidence reveals. The only apparent standard for an acceptable level of risk is to meet pipeline safety standards—which Atmos is apparently doing at present. Developing specific goals for reducing the risk of harm to persons and property would seem to be a logical first step to make before approving any sort of measures intended to accelerate infrastructure replacement. Otherwise, regulators will have no means of measuring the success of such efforts or determining whether the costs are justified by the results.

Regulators also should be wary of allowing their concerns over recent high-profile natural gas explosions to lead to the assumption that every jurisdiction is facing the same degree of danger.

Some infrastructure problems are worse than others, and regulators should refrain from assuming that serious problems exist in all communities. Even the NARUC resolution that was touted by Atmos as support for approving more shareholder-friendly perks to encourage infrastructure replacements explicitly recognized that the needs and circumstances of each area are unique, and that the regulators in each state are best suited to determine now to finance any needed replacements. (Crane, Tr. Vol. 2, at 357-58). There is no reason to resort to extraordinary financing mechanisms in response to the general sense of crisis. Regulators first should establish that there is a problem that is not being addressed before looking for solutions. Further, regulators should not blindly assume that spending more by providing incentives to shareholders will automatically result in lower risk for the public. As Mr. Haynos noted, there is no such thing as a risk-free natural gas system. (Tr. Vol. 2, at 376-77). There is a limit to which spending alone will reduce the risk. Statistics indicate that most major natural gas incidents are caused by human behavior: defective welding of pipes, contractors digging into gas lines, vehicles running into meters and other above-ground structures, and utility employees failing to follow safety procedures and the like. (CURB Exh. 8). Only about 5% of major incidents are caused by corrosion , and the material guilty of the greatest number failures due to corrosion is cast-iron. (CURB Exh. 8; Haynos, Tr. Vol. 2, at 409). Spending on infrastructure replacements only tackles a small portion of the problems that lead to explosions.

Staff pipeline safety witness Leo Haynos mentioned an excellent example of the sort of incident that has raised concerns about our aging natural gas infrastructure nationwide. He noted the attention to such matters increased after a couple of major natural gas explosions in downtown Philadelphia. (Haynos, Tr. Vol. 2, at 374). Haynos testified that the Philadelphia incidents were

caused by cast-iron failures. (Haynos, Tr. Vol. 2, at 374), and noted that cast-iron is four times as likely as other types of pipe to fail catastrophically. (Haynos, Tr. Vol. 2, at 409). He also testified that Atmos's Kansas system has no cast-iron pipe at all. (*Id.*, at 409). So although Atmos has older bare steel pipe and pipes of other materials that are now considered obsolete, its Kansas system is less likely to experience the sort of catastrophic failures that have occurred in Philadelphia and other communities with cast-iron pipes. In fact, Haynos testified that he does not regard the aging condition of Atmos's system in Kansas to be a crisis at this time *(Id.*, at 382), but he would like to see Atmos come forward with a plan to replace aging infrastructure that has a deadline and that demonstrates it is improving safety. (*Id.*, at 418). He said that the only plan he could discern in Atmos' application is to get incentives to spend more money. (*Id.*).

To caution the Commission against acting without a specific plan and goals is not to deny that Atmos has bare steel pipe and pipes of other materials that are considered obsolete and need replacement. But it would be reasonable and rational to first establish the extent of the problem and to assess the risks before delving into the question of whether Atmos needs to attract more investors to address the problem. Awarding shareholder incentives before determining that they are needed is putting the cart before the horse. And Atmos provided no evidence that would permit the Commission to make such a determination. Even if the Commission ultimately determines that Atmos needs to invest more money in infrastructure replacements, adopting the RA proposal provides only the opportunity for Kansas to improve its odds of being competitive in the intra-corporate competition within Atmos for "discretionary" dollars. No one testifying for Atmos said that adopting this RA mechanism will definitely result in more dollars flowing to the Kansas division for infrastructure replacements, and we heard no promises that every extra dollar flowing

to Kansas will be devoted to infrastructure replacements. There is nothing to keep Atmos from making the decision, for example, to use the money to reward the Kansas division management for its success in attracting more shareholders instead. All we have been promised is "a seat at the table": whether the Kansas division will come away from the table with tangible benefits for customers and the public is uncertain.

It is important to consider whether the odds are good of coming away from the table with increased benefits and reduced risk for the Kansas division. Atmos witnesses warned again and again that Kansas is already behind six of the eight states in which it does business in providing shareholder perks. But taking a realistic look at what we are competing against would lead to the conclusion that it is unlikely that the Kansas division of Atmos will ever be truly competitive in the intra-company race to please shareholders—unless state law and policy changes radically. Mr. Armstrong testified that one of the utilities owned by Atmos is in a state that allows utilities to "actually start earning on that investment before it's even used and useful and in service for the customer." (Armstrong.,Tr. Vol. 2, at 290-91). Obviously, that state doesn't have a "construction work in progress" statute that requires utility plant in most circumstances to be used and useful before the utility is allowed to recover its cost in rates. (*See* K.S.A. 66-128—which provides a few limited exceptions to the "used and useful" requirement that mostly apply to electric plant, not natural gas plant).

Kansas also requires the Commission to balance the interests of the utilities, the ratepayers and the public in making its determinations. (*Columbus Telephone Co.,* 4 Kan. App. 2d at 836). For Kansas to get a realistic chance of coming away from the table with increased discretionary dollars in Atmos's intra-company competition would require the Commission to adopt policies that

the Commission isn't authorized to adopt. The legislature would have to vote out the "used and useful" law and enact legislation that requires the Commission to favor shareholders when balancing the interests of shareholders, customers and the public. "Zero lag"—the ultimate goal of Atmos for all system integrity spending--would have to become the standard for ratemaking in Kansas, which would take away a valuable cost-containment tool for regulators. (Christian, Tr. Vol. 2, at 323; Grady, Tr. Vol. 2, at 439).

Until the Kansas regulatory regime undergoes such a revolution, it would be more reasonable for the Commission to deny the company's proposed RA mechanism. If the Commission has concerns about whether the pace of Atmos's Kansas infrastructure replacements poses an unreasonable risk to the public, the Commission has the authority to investigate, assess the risks, and set goals for reducing those risks. Unless and until a problem is identified and the Commission has determined that Atmos should accelerate the pace of its replacements, there is no reason to resort to providing shareholder perks, especially under the terms presented by Atmos in its application. If, after investigation, the Commission should ultimately decide that Kansas customers should shoulder more of the risk and provide more benefits to shareholders in order to secure a greater commitment from Atmos to make infrastructure replacements, Atmos should be required to provide a firm commitment to the Kansas division that it will receive an increase in system integrity replacements that is proportionate to the additional benefits provided by customers to shareholders, and should be required to make a commitment to meet goals for reducing the public risk as determined by the Commission.

III. Summary and requests for relief

The evidence presented in this case supports a decision by the Commission to allow Atmos Energy's Kansas division a return on equity of 8.5%, as CURB recommended, or no more than 9%, as Staff recommended. An ROE in this range would be reasonable and permit Atmos to attract investors, while providing safe and reliable service at reasonable rates.

The evidence in the record indicates that the primary purpose of the RA mechanism is to provide a benefit to Atmos's shareholders, rather than to enhance system integrity. Allowing Atmos to implement the RA mechanism would confound the intent of the legislature by providing more relief from regulatory lag than the legislature intended to provide. The RA would also permit the company to collect the costs of taxes that the company does not pay, thereby inflating the costs passed through to customers. The purported benefits to Kansas customers of adopting the RA mechanism are speculative at best, and at worst, may be a tradeoff that yields no tangible benefit of reduced risk to Kansas at all. The Commission should deny the company's proposal to implement the RA mechanism.

Therefore, for all the reasons stated above, CURB respectfully requests that the Commission approve an ROE for Atmos between 8.5% and 9%, and deny the company's proposal for the RA mechanism.

Respectfully submitted,

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VERIFICATION

STATE OF KANSAS)
) ss:
COUNTY OF SHAWNEE)

I, Niki Christopher, 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.

Niki Christopher

SUBSCRIBED AND SWORN to before me this 28th day of July, 2014.

Notary Public

DELLA J. SMITH
Notary Public - State of Kansas
My Appt. Expires January 26, 2017

My Commission expires: 01-26-2017.

CERTIFICATE OF SERVICE

14-ATMG-320-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 28th day of July, 2014, to the following parties:

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