THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

Before Commissioners: Dwight D. Keen, Chair
Shari Feist Albrecht
Susan K. Duffy

In the Matter of the Application of Atmos Energy to Amend Its Demand Charge Savings Provision in its Purchased Gas Adjustment (PGA) Tariff	))))	Docket No. 19-ATMG-486-TAR

NOTICE OF FILING OF STAFF'S REPORT & RECOMMENDATION [REDACTED VERSION]

COMES NOW, the staff of the Kansas Corporation Commission (Staff and Commission, respectively), and files the redacted version of its Report and Recommendation regarding Atmos Energy Corporation's (Atmos) application for approval to amend its Demand Charge Savings Provision in its Purchased Gas Adjustment Tariff,

WHEREFORE, Staff submits it's Report and Recommendation for Commission review and consideration and for such other relief as the Commission deems just and proper.

Respectfully Submitted

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Shari Feist Albrecht, Commissioner
Susan K. Duffy, Commissioner

Laura Kelly, Governor

REPORT AND RECOMMENDATION
UTILITIES DIVISION

REDACTED VERSION
[redacted] Denotes Confidential Information

TO: Chairman Dwight D. Keen
Commissioner Shari Feist Albrecht
Commissioner Susan K. Duffy

FROM: Chad Unrein, Managing Auditor/FERC Affairs Specialist
Justin Grady, Chief of Accounting and Finance
Lana Ellis, Deputy Chief of Economics and Rates
Robert Glass, Chief of Economic Policy and Planning
Jeff McClanahan, Director

DATE: September 27, 2019

SUBJECT: Docket No. 19-ATMG-486-TAR: In the Matter of the Application of Atmos Energy to Amend Its Demand Charge Savings Provision in its Purchased Gas Adjustment Tariff.

EXECUTIVE SUMMARY:

On May 24, 2019, Atmos Energy Corporation (Atmos) filed an Application that requests approval to amend its Demand Charge Savings Provision in its Purchased Gas Adjustment (PGA) Tariff in Docket No. 19-ATMG-486-TAR. The Demand Charge Savings Provision was established when the Kansas Corporation Commission (Commission) approved a Stipulated Settlement Agreement in Docket No. 14-ATMG-230-TAR (14-230 Docket).[1] The Commission authorized Atmos to include a Performance Based Ratemaking (PBR) mechanism sharing the demand charge savings between Atmos' ratepayers and shareholders for a five-year Transportation Agreement (Agreement) with Southern Star Central Pipeline (Southern Star). Pursuant to paragraph 13 of the Stipulated Settlement Agreement (Settlement Agreement), Atmos was required to file additional Applications with the Commission to extend the Demand Charge Savings Provision to cover subsequent pipeline capacity agreements.

In its current Application, Atmos is seeking to amend the Demand Charge Savings Provision to apply to all future interstate and intrastate pipeline capacity agreements with any natural gas

[1] *See* Commission's Order approving the Unanimous Stipulation and Agreement filed on April 7, 2015; http://estar.kcc.ks.gov/estar/ViewFile.aspx?Id=282807e1-289b-4f4d-b66b-c02380674d67.

pipeline and remove the requirement that Atmos file separate Applications before the Commission for future pipeline capacity agreements. As part of its request, Atmos is seeking to maintain the current sharing percentages contained in the Settlement Agreement for future pipeline capacity agreements with customers receiving 78% of the savings and shareholders retaining 22% of the savings. While the Southern Star Agreement does not expire until November 30, 2020, Atmos is requesting the amendment of its PGA prior to the notification date in the Agreement. Atmos must provide notice to Southern Star whether it intends on entering into a new agreement with the pipeline prior to November 30, 2019. After a thorough review of the Application, Staff recommends the Commission approve Atmos' Application to amend the Demand Charge Savings Provision as requested.

BACKGROUND:

On November 15, 2013, Atmos filed its initial Application seeking to amend its PGA to include a Demand Charge Savings Provision and Pipeline Bypass Savings Component in the 14-230 Docket. Atmos argued the Demand Charge Savings Provision will directly incentivize Atmos to consider non-traditional supply practices to reduce pipeline demand charges and allow Atmos to capture savings on behalf of its ratepayers and shareholders from the restructuring of its natural gas supply contracts.[2] The Demand Charge Savings Provision was broken into three subcomponents: Segmentation Savings; Pipeline Discount Savings; and Delivered Services Savings.[3] The Pipeline Bypass Savings Component would allow Atmos to explore opportunities to construct new interconnects with alternative pipelines and realize an overall cost savings by increasing capacity on pipelines that are more expensive.[4] The customers' share of the savings would flow directly through the PGA via reduced demand charges similar to the approved capacity release mechanism. In its initial Application in the 14-230 Docket, Atmos sought to split the savings between customers and shareholders equally with ratepayers retaining 50% of the savings and shareholders retaining 50% of the savings.

As a result of the meeting with Staff, Atmos filed an Amended Application on April 24, 2014. The Amended Application retained both the Demand Charge Savings Provision and the Pipeline Bypass Savings Component to the PGA; however, instead of splitting the savings equally between customers and shareholders, all of the savings would be used by Atmos to fund certain qualified capital projects. The projects would fall within the following categories: (1) capital projects to provide natural gas service to under-served areas; (2) capital projects that would reduce gas supply costs; and (3) other capital projects approved by the Commission.

Due to the lengthy procedural history of the 14-230 Docket, Staff will provide a high-level overview of the remaining background information. The Citizens' Utility Ratepayer Board (CURB) & Kansas City Power & Light Company (KCP&L) were granted intervention. Staff recommended approving the Amended Application with certain modifications, which included revising the proposed tariff language and modifying the demand charge savings sharing percentages with 75% going towards qualified projects and the remaining 25% passed back to customers as a credit through the PGA. CURB objected to the Amended Application in its entirety.[5] KCP&L recommended the Amended Application be denied arguing the program

[2] *See* the Direct Testimony of Sheri W. Rowe, p. 2 in 14-230 Docket.

[3] *See id, p.2-3,* for a detailed explanation of the three subcomponents of the Demand Charge Savings Provision.

[4] *See id, p. 3.*

[5] *See* the Direct Testimony of Stacey Harden, filed on 7/18/14 in the 14-230 Docket.

provides a subsidy for uneconomic natural gas projects distorting the competitive balance between natural gas and electric public utilities that had been in place for many years.[6] An evidentiary hearing was held on August 28, 2014. On October 14, 2014, the Commission issued its Order denying Atmos' Amended Application; however, the Commission directed the Parties "to engage in dialog to pursue policy options that might incentivize Atmos to capture potential demand charge reductions" from the interstate pipeline companies that provide transportation services to the gas utility.[7] On October 29, 2014, Atmos filed a Petition for Reconsideration and Clarification asking for clarification of the Commission's Order so the Parties could better understand how to follow the Commission's directive.[8] On November 25, 2014, the Commission issued an Order granting reconsideration, which found that additional consideration of Atmos' proposal was appropriate and asked the Parties to collaborate on a procedural schedule.[9]

The Parties met several times following the Commission's Order. At one of the meetings, Atmos informed Staff and CURB that it had been successful in negotiating a significant discount in the demand charges with Southern Star under its five-year Agreement. Staff and CURB reviewed the conditions of the Southern Star Agreement to confirm the demand charge savings. As a result, the Parties reached a Settlement Agreement that resolved all of the issues in the Docket. While KCP&L was not a signatory to the Settlement Agreement, KCP&L informed Atmos that it did not oppose the Settlement Agreement. The Settlement Agreement included a limited Demand Charge Savings Provision relating specifically to the Pipeline Discount Savings subcomponent that was narrowly applied to the Southern Star Agreement. The Settlement Agreement excluded certain components of the Amended Application including the Segmentation Saving subcomponent and the Delivered Services subcomponent of the Demand Charge Savings Provision, as well as the Pipeline Bypass Savings Component. Atmos was required to file a separate Application with the Commission for any future pipeline capacity agreement, and the Settlement Agreement split the savings between Atmos' customers and Atmos' shareholders with 78% of the savings going to customers and 22% going to shareholders. On February 23, 2015, the Parties filed a Joint Motion seeking the Commission approve the Settlement Agreement. On April 7, 2014, the Commission issued an Order approving the Settlement Agreement authorizing Atmos to amend its PGA Tariff to include a Demand Charge Savings Provision related to the Southern Star Agreement.[10]

In the current Docket, Atmos filed its Application requesting approval to amend its Demand Charge Savings Provision in the PGA Tariff to apply to all future interstate and intrastate pipeline capacity agreements. Pursuant to paragraph 13 of the Settlement Agreement, Atmos was required to file a separate Application before the Commission to extend the incentive sharing mechanism to cover any future pipeline capacity agreements.[11] While Atmos' Agreement with Southern Star does not expire until November 30, 2020, Atmos must notify Southern Star if it intends on entering into a new agreement with the pipeline before November 30, 2019. The transportation agreement with Southern Star has produced approximately $4.74

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[6] *See* the Cross-Answering Testimony of Emeka Y. Anyanwu, p. 4, lines 15-19.
[7] *See* Commission Order denying Application, page 4, filed on October 14, 2014.
[8] *See* Petition for Reconsideration and Clarification, page 19, filed on October 29, 2014.
[9] *See* Order Granting Reconsideration, p. 4, filed on November 25, 2014.
[10] *See* Commission's Order approving the Unanimous Stipulation and Agreement.
[11] *See id, Exhibit A: Stipulated Settlement Agreement, Section 13, page 3-4.*

million[12] of benefit to ratepayers through May of 2019, and Atmos estimates that ratepayer benefit will total approximately $7 million over the life of the contract.[13]

ANALYSIS:

Staff reviewed Atmos' Application and the Direct Testimony from Atmos witness Sheri Rowe. As part of Staff's review in the Docket, Staff issued discovery and held a technical conference on August 23 to discuss certain elements of Atmos' Application. The technical conference focused on clarifying Atmos' purpose in broadening the Demand Charge Savings Provision to include any future pipeline capacity agreements and whether Atmos has identified other pipeline contracts to produce additional demand savings. Atmos reaffirmed that the primary drivers for filing the Application are the notification requirement in the Southern Star Agreement to declare if Atmos intends on entering into a new agreement and the provisions of the Settlement Agreement requiring Atmos to file a separate Application to share in any future capacity agreements for discounted rates. Atmos stated that its request to amend the PGA Tariff to include all future contract negotiations has the possibility to lead to future discounted rate agreements with other pipelines as pipeline capacity contracts expire. While Atmos indicated that the potential exists to renegotiate other capacity contracts in the future, Atmos is not currently in the process of any renegotiations with other pipelines. Atmos clarified that its request to expand the Demand Savings Provision to all interstate and intrastate pipeline capacity agreements has other potential benefits, such as reducing the administrative cost of filing future Applications with the Commission and providing additional notice to natural gas pipelines that the Commission is supportive of Atmos' efforts to reduce demand pricing on future capacity contracts. Atmos witness Shari Rowe highlights the effects of the Commission's support:

> [t]he Commission's Order on Reconsideration and the Staff and CURB support for the adoption for a regulatory incentive assisted Atmos Energy in negotiating the discounted rate from Southern Star under the 2015 Southern Star Agreement. Southern Star was aware that this mechanism created a stronger regulatory incentive for Atmos Energy to reduce its capacity costs by negotiating with an alternative pipeline to transport gas supplies at a rate below that charged by Southern Star.[14]

Performance Based Ratemaking:

PBR mechanisms are not new to the Commission and can be used as a supplement to traditional ratemaking methodology. In certain circumstances, PBR mechanisms can be employed to incentivize a utility to control costs as a useful substitute for regulatory lag. In the Order approving the capacity release revenue sharing mechanism in Docket No. 190,061-U (190-061-U Docket), the Commission stated,

> [the] Commission believes that allowing an LDC (local distribution company) to share in the revenue will be more likely to induce prudent and efficient capacity release than the threat of a regulatory investigation alone.[15]

[12] *See* Direct Testimony of Sheri Rowe, attached Exhibit SWR-1 in the 19-486 Docket.
[13] *See id, page 6, line 6-9.*
[14] *See id, page 4, lines 18-22, and page 5, line 1.*
[15] *See* Commission Order, page 10, in Docket No. 190,061-U filed on May 2, 1995.

To further emphasize the Commission's objective in the 190-061-U Docket, the Commission stated,

> [the] Commission's ultimate goal is to devise a gas incentive mechanism, perhaps a performance based mechanism, which addresses gas purchasing activities as a whole, rather than just the capacity resale decision.[16]

In Staff's opinion, the extension of the Demand Charge Savings Provision to all future interstate and intrastate negotiated rate agreements furthers this objective.

In his Testimony in the 14-230 Docket, Staff witness Dr. Robert Glass details Staff's position regarding PBR mechanisms and discusses the merits of Atmos' request to establish an incentive structure by incorporating the Demand Charge Savings Provision and Pipeline Bypass Component in its PGA. These PBR mechanisms were designed to provide an incentive to Atmos to explore alternative strategies to procure pipeline capacity while passing back some of the savings to Atmos' customers.[17] Prior to the implementation of the incentive mechanisms, the PGA tariff served as a pass-through mechanism to allow Atmos to fully collect the actual cost of gas to customers.[18] If Atmos would have expended resources and employee time to develop alternative fuel procurement methods to reduce transportation charges, these costs would not be recoverable through the PGA. Atmos could seek to recover these expenditures at the time of its next general rate case; however, Atmos may not receive any cost recovery for its efforts if the expenses were incurred outside of the test year in the rate case. From Atmos' perspective, there is the real risk to potentially lose money and expend employee resources to negotiate capacity contracts on behalf of its customers.[19] Thus, an incentive mechanism helps to balance the risks of increased costs by sharing the benefit of the demand charge savings with Atmos. Without this incentive, Atmos' customers will likely continue paying the pipeline's max transportation rate.

<u>Overview of Atmos' PBR Programs in Other States:</u>

Staff issued discovery to request Atmos to detail PBR programs approved in other state jurisdictions. In response to KCC Data Request No. 1, Atmos detailed its approved PBR programs in other states along with the sharing percentages of the programs and the total customer savings generated over the last five years. While Atmos' customer savings data is confidential, the data demonstrates that Atmos has committed company resources to effectively use the PBR program to produce savings on behalf of its customer. Staff has included Atmos' response to KCC Data Request No. 1 detailing the historical savings information in Confidential Attachment A for the Commission's review. With regard to the public information about the PBR programs, Atmos has approved programs in five of the eight states in which it operates. The three states without PBR programs are Colorado, Virginia, and Texas, which have limited pipeline supply options, geographic constraints, and/or natural gas supply primarily provided by an Atmos affiliated pipeline. The five states with approved PBR programs are Kansas, Kentucky, Louisiana, Mississippi, and Tennessee. The following table shows a breakdown of Atmos' current PBR programs and details the category of the incentive mechanism with the sharing percentages between ratepayers and shareholders.[20]

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[16] *See id, page 13.*
[17] *See* Direct Testimony of Robert H. Glass, PhD., page 3, line 12-13.
[18] *See id, lines 18-19.*
[19] *See id, lines 19-22.*
[20] *See* Confidential Attachment A: Discovery. Staff's table is a reproduction of the public information available on the PBR programs.

Savings Category	Kansas	Kentucky (1)	Louisiana (2)	Mississippi (3)	Tennessee
	Customer/Atmos Sharing Percentages				
Demand Charge -					
Segmentation	-	-	50/50	100/0	-
Discounts	78/22	Max 70/30	50/50	100/0	85/15
Delivered	-	Max 70/30	50/50	100/0	85/15
Pipeline Bypass	-	Max 70/30	50/50	100/0	-
Capacity Release	50/50	Max 70/30	50/50	100/0	75/25
Commodity	-	Max 70/30	50/50	100/0	75/25

(1) Kentucky PBR has two different levels of sharing. As the savings increase beyond 2% of total cost, the sharing percentage changes to 50/50.
(2) Louisiana PBR value is shared with a non-utility affiliate (TLGP) of Atmos.
(3) Prior to June 2018, the sharing percentage was 50/50, but because of a large rate settlement where Atmos received other incentives, the sharing changed from 50/50 to 100% of the savings flowing to customers.

Market Dynamics

Atmos has stated that the Commission's support of the Demand Charge Savings Provision was an important step in obtaining a negotiated rate contract with Southern Star. Atmos will begin to renegotiate a new transportation agreement with Southern Star following the notification date of November 30, 2019, in the Agreement. One of the key topics discussed in the technical conference was the changing market dynamics specifically related to the Southern Star Pipeline Modernization Program and whether the Modernization Surcharge will impact the renegotiation of the Southern Star transportation agreement. The Modernization Program allowed Southern Star to invest up to $88 million per year in customer-approved eligible facilities that will be placed into service during the calendar years of 2019 and 2020. The surcharge applies to max rate shippers and terminates with the effective date of the next general rate case, subject to true-up. Southern Star is obligated to file its general rate case to go into effect no later than November 1, 2021. While Atmos was uncertain whether the Modernization Surcharge will have a direct effect on the outcome of the renegotiation of a new agreement, the escalating surcharge rate is an important element in evaluating Atmos' options in obtaining fuel from an alternative pipeline. By expanding the Demand Charge Saving Provision to other pipelines, Atmos believes the Commission's approval will send a signal to natural gas pipelines that the Commission is incentivizing Atmos to explore alternative fuel procurement methods with other pipelines to negotiate for lower demand charge rates on behalf of Kansas customers.

Summary of Staff's Analysis

In certain situations, PBR mechanisms can be effective regulatory policy by further incentivizing the utility to reduce customer costs. Atmos' Agreement with Southern Star has generated approximately $5 million of benefit to Kansas ratepayers to date and an estimated $7 million over the life of the contract. Additionally. Atmos has a demonstrated a track record for producing customer savings in the five states with approved PBR programs. Upon reviewing the entirety of the Application, Staff is supportive of Atmos' request to extend the Demand Charge Savings Provision to all future interstate and intrastate negotiated rate capacity contracts and remove the requirement that Atmos file separate Applications for approval of future pipeline capacity agreements. Further, Staff supports Atmos' request to retain the current sharing ratio, allocating 78% of the savings to Atmos' ratepayers and 22% of the savings to Atmos' shareholders. These percentages were negotiated by the Parties as part of a Settlement Agreement and have been approved by the Commission as just and reasonable. The amendment of the Demand Charge Savings Provision will reduce the administrative burden and costs of filing subsequent Applications before the Commission for future capacity agreements, which maximizes the benefit of the PBR program for customers. The Commission's support of the PBR program sends a signal to natural gas pipelines that the Commission is interested in Atmos exploring alternative fuel procurement methods to lower the demand charges paid by Kansas customers and is consistent with the Commission's goal of addressing gas purchasing activity as a whole through the use of an incentive structure.

RECOMMENDATION:

After a thorough review of the Application, Staff recommends the Commission approve Atmos' Application to amend the current Demand Charge Savings Provision to apply to all future interstate and intrastate pipeline capacity agreements; remove the requirement that Atmos file separate Applications before the Commission for approval of future pipeline capacity agreements; and maintain the current approved sharing ratio with Atmos' customers retaining 78% of the savings and Atmos' shareholders retaining 22% of the savings for all future pipeline capacity agreements. Additionally, Staff recommends the Commission adopt Atmos' proposed revisions to the red-lined PGA Tariff contained in the Direct Testimony of Sheri Rowe's Exhibit SWR-2.

Attachment A: Redacted Discovery

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CERTIFICATE OF SERVICE

19-ATMG-486-TAR

I, the undersigned, certify that a true and correct copy of the above and foregoing Notice of Filing of Staff's Report and Recommendation (PUBLIC VERSION) was served via electronic service this 30th day of September, 2019, to the following:

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19-ATMG-486-TAR

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