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

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

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

ORDER ON ATMOS ENERGY CORPORATION'S APPLICATION FOR A RATE INCREASE

This matter comes before the State Corporation Commission of the State of Kansas (Commission). Having reviewed the pleadings and record, the Commission makes the following findings:

1. On June 28, 2019, Atmos Energy Corporation (Atmos) filed an Application seeking an overall net revenue increase of $7.2 million, resulting from increasing 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 its Ad Valorem Tax Surcharge Rider (AVTS) into base rates.[1]

2. Atmos claims their current rates do not produce sufficient revenues to cover the costs to render reasonably sufficient and efficient service and, therefore, are not just and reasonable.[2] Without the proposed rate increase, Atmos contends it will be unable to acquire necessary capital at reasonable rates, carry out new construction, provide adequate gas supplies of gas and render the quality of service the public requires.[3] Atmos's Application is accompanied by supporting testimony from eight witnesses.[4]

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[1] Application, June. 28, 2019, ¶ 4.
[2] *Id.*, ¶ 5.
[3] *Id.*
[4] *Id.*, ¶ 4.

3. The Commission has jurisdiction to supervise and control natural gas public utilities, as defined in K.S.A. 66-104, doing business in Kansas.[5] The Commission has the power to require all natural gas utilities governed by the Natural Gas Public Utilities Act to establish and maintain just and reasonable rates.[6]

4. Notice of the proposed rate increase, public hearing, and evidentiary hearing was provided by an insert with the monthly billing statement for each customer in Atmos's service territory as well as by publishing notice in the major newspapers in the region. The Commission received comments from the public at the September 17, 2019 public hearing in Overland Park, Kansas, where a record was made. The Commission also received 527 public comments through its Office of Public Affairs and Consumer Protection.[7] The Commission issues this Order with due consideration of those comments.

5. On July 25, 2019, the Citizens' Utility Ratepayer Board (CURB) was granted intervention.

6. On October 31, 2019, Commission Staff (Staff)[8] and CURB filed their direct testimony. In its direct testimony, Staff recommended a net revenue decrease of $593,764; CURB recommended a net revenue decrease of $3,157,324.[9]

7. On November 18, 2019, Atmos filed rebuttal testimony from eight witnesses. James F. Reda and John D. Quackenbush filed rebuttal testimony without having filed direct testimony. Reda's testimony focused on the reasonableness of total compensation levels for

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[5] K.S.A. 66-1,201.
[6] K.S.A. 66-1.202.
[7] The public comments were entered into the record by the Prehearing Officer filing Notice of Filing of Public Comments on Dec. 18, 2019.
[8] Staff served the Direct Testimony of Justin T. Grady and Adam H. Gatewood on all parties via email on October 31, 2019. Due to a clerical error neither Grady's nor Gatewood's testimony was filed by 5:00 p.m. on October 31, 2019. On November 14, 2019, the Commission granted Staff's Motion for Leave to File Testimony Out of Time.
[9] Post-Hearing Brief of Commission Staff (Staff Brief), Jan. 16, 2020, ¶¶ 5, 6.

executives and the appropriateness of Atmos's annual and long-term incentive compensation programs.[10] Quackenbush's rebuttal testimony discussed the alternative regulatory mechanisms he approved for natural gas companies while he chaired the Michigan Public Service Commission,[11] and opined on the importance of Regulatory Research Associates' (RRA) assessments of state regulatory climates.[12]

8. The Parties were unable to reach a settlement, so the Commission held an evidentiary hearing, beginning December 10, 2019, and concluding December 12, 2019. Atmos, Staff, and CURB appeared by counsel and each party submitted prefiled testimony. The Commission heard live testimony from a total of 20 witnesses, including nine on behalf of Atmos, seven on behalf of Staff, and four on behalf of CURB. At the December 3, 2019 prehearing conference, the parties agreed to waive cross-examination of several witnesses. The parties had the opportunity to cross-examine the remaining witnesses at the evidentiary hearing as well as the opportunity to redirect their own witnesses. Following the evidentiary hearing, all of the parties submitted post-hearing briefs.

9. The major issues in dispute are:

- Return on Equity (ROE) / Capital Structure
- System Integrity Plan (SIP)
- Incentive Compensation
- Depreciation
- Rate case expense
- Other rate base and income statement adjustments

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[10] Rebuttal Testimony of James F. Reda, Nov. 18, 2019, p. 3.
[11] Rebuttal Testimony of John D. Quackenbush, CFA (Quackenbush Rebuttal), Nov. 18, 2019, p. 12.
[12] *Id.*, pp. 14-15.

10. In determining rates, the Commission first establishes a revenue requirement and then designs a rate structure.[13] The revenue requirement includes rate base, operating expenses, and rate of return.[14] The rate of return is simply an opportunity to earn that rate, not a guarantee. Rate design includes allocating costs among and within the customer classes.

11. In setting rates, the Commission's goal is to balance the interests of all concerned parties and develop a rate within the "zone of reasonableness."[15] The parties whose interests must be considered and balanced include: (1) the utility's investors vs. the ratepayers; (2) present vs. future ratepayers; and (3) the public interest.[16]

12. In allocating the revenue requirement among the customer classes, the Commission follows cost causation principles,[17] so "that one class of consumers shall not be burdened with costs created by another class."[18]

A. RETURN ON EQUITY

13. Atmos initially proposed an ROE of 10.25%, with an overall rate of return of 7.98%.[19] Its witness, Dylan D'Ascendis, reached his ROE recommendation after applying several cost of common equity models, including the Discounted Cash Flow (DCF) model, the Risk Premium Model (RPM), and the Capital Asset Pricing Model (CAPM), to a proxy group of six natural gas distribution utilities and a separate proxy group of sixteen domestic, non-price regulated companies of comparable risk to the six natural gas companies.[20] D'Ascendis's models produced an ROE of 9.8% before he adjusted it upward by 0.40% for the small size of Atmos

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[13] *Kansas Gas & Elec. Co. v. Kansas Corp. Comm'n*, 239 Kan. 483, 500 (1986).
[14] *Id.* at pp. 500-01.
[15] *Id.* at pp. 488-89.
[16] *Id.* at pp. 488, 1070.
[17] *See* Order on Petitions for Reconsideration and Clarification, ¶¶ 14-15, Docket No. 05-WSEE-981-RTS (Feb. 13, 2006).
[18] *Jones v. Kansas Gas & Elec. Co.*, 222 Kan. 390, 401 (1977).
[19] Direct Testimony of Dylan W. D'Ascendis (D'Ascendis Direct), June 28, 2019, p. 2.
[20] *Id.*, p. 3.

Kansas's operations and another 0.04% for flotation costs to arrive at an ROE of 10.24%.[21] Inexplicably, D'Ascendis's rounded up to 10.25% to reach his initial recommendation.[22]

14. CURB's witness, Dr. J. Randall Woolridge, applied the DCF and CAPM to his own proxy group of gas distribution companies and concluded Atmos's ROE is in the range of 7.50% to 8.70%,[23] ultimately recommending an ROE of 8.7%.[24]

15. Staff recommends an ROE of 9.1%, with a range of 8.55% to 9.35%.[25] Staff witness Adam Gatewood's ROE of 9.1% results in an overall rate of return of 7.02%.[26] Gatewood performed DCF, Internal Rate of Return (IRR), and CAPM analyses using D'Ascendis's proxy group.[27] He relied on a DCF model using both short-term and long-term growth rate forecasts to arrive at a midpoint ROE of 8.15%.[28] Applying long-term growth rate forecasts to D'Ascendis's proxy group is one explanation for why Gatewood's recommended ROE is lower than D'Asendis's.

16. In his rebuttal testimony, D'Ascendis lowered his initial ROE recommendation from 10.25% to 9.9%,[29] based on an extraordinary decline in interest rates since he filed his direct testimony.[30] In his revised ROE recommendation, D'Ascendis starts with an ROE of 9.45% before applying a 0.40% upward size adjustment and a 0.03% flotation cost adjustment to arrive at his 9.9% ROE recommendation.[31]

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[21] *Id.*, p. 4.
[22] *Id.*
[23] Direct Testimony of J. Randall Woolridge, Ph.D. (Woolridge Direct), Oct. 31, 2019, p. 4.
[24] *Id.*, p. 58.
[25] Direct Testimony of Adam Gatewood (Gatewood Direct), Nov. 5, 2019, p. 2.
[26] *Id.*, p. 2. Gatewood's 7.02% overall rate of return is based on a 4.35% cost of debt. *See id.*, p. 3. Applying the 4.37% cost of debt the Commission adopts in paragraph 29 of this Order increases his overall rate of return to 7.03%.
[27] Staff Brief, ¶¶ 16-18.
[28] *Id.*, ¶ 17.
[29] Rebuttal Testimony of Dylan W. D'Ascendis (D'Ascendis Rebuttal), Nov. 18, 2019, p. 2.
[30] *Id.*, p. 5.
[31] *Id.*, p. 4.

17. In determining the appropriate ROE, the Commission is guided by *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591 (1944) and *Bluefield Waterworks & Improvement Company v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923) which find returns granted to regulated public utilities should be: (1) commensurate with returns on investment of similar risk; (2) sufficient to ensure the utility's financial integrity under proper management; and (3) adjusted to reflect changes in the money market and business conditions.[32] *Hope* and *Bluefield* have been adopted by the Kansas Supreme Court[33] and recognized by the Commission in Docket No. 10-KCPE-415-RTS (10-415 Docket).[34] While the Commission has substantial discretion in setting a fair rate of return, it must not be so unreasonably high or low as to be unlawful.[35]

18. Even after amending its proposed ROE in recognition of an extraordinary decline in interest rates, Atmos's proposed 9.9% ROE represents an increase of 80 basis points from its currently approved ROE of 9.1%.[36] Both Gatewood and Woolridge testified that there has been a clear downward trend in authorized ROEs for gas and electric utilities from 2000 to 2018.[37] Even Atmos acknowledges an overall downward trend in interest rates since 2008.[38] Atmos is the only party advocating an increase to its 9.1% ROE. Atmos's proposed ROE runs counter to the trends in Kansas and nationwide towards lower ROEs in recognition of historically low costs of capital.

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[32] *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603, 64 S.Ct. 281, 288 (1944); *Bluefield Waterworks & Improvement Co. v. Public Service Comm'n of West Virginia*, 262 U.S. 679, 692-93, 43 S.Ct. 675, 679 (1923).
[33] *Kansas Gas*, 239 Kan. at pp. 489-90.
[34] Order: 1) Addressing Prudence; 2) Approving Application, In Part: and 3) Ruling on Pending Requests (10-415 Order), pp. 40-41, Docket No. 10-KCPE-415-RTS (Nov. 22, 2010).
[35] *Southwestern Bell Tel. Co. v. Kansas Corp. Comm'n*, 192 Kan. 39, 85-86 (1963).
[36] *See* Gatewood Direct, p. 30.
[37] Transcript of Evidentiary Hearing (Tr.), Dec. 10, 2019, Vol. 1, p. 48 (Woolridge); *id*, pp. 159-160 (Gatewood).
[38] D'Ascendis Rebuttal, pp. 5-6.

19. On cross-examination, D'Ascendis admits that the only model that produces a 9.9% ROE applies to companies that are not price/rate regulated with adjustments for company size and equity flotation.[39] Yet, D'Ascendis is unaware of any instance where the Commission has recognized a size adjustment in setting an ROE.[40] With an equity market capitalization of $11.4 billion, Atmos is hardly a small company.[41] Staff questioned the appropriateness for a size adjustment because an investor cannot purchase stock specific to Atmos's Kansas operations nor can anyone purchase debt specific to Atmos's Kansas operations.[42]

20. As Quackenbush testified, Atmos Kansas makes up only about 4% of Atmos's operations, so when investors contemplate investing in Atmos, they focus on states like Texas, Mississippi and Louisiana that make up the lion's share of Atmos's operations, and therefore, the regulatory risk that exists in those three states more significantly impacts Atmos's ability to attract capital.[43] Similarly, Quakenbush admits that Atmos is not currently experiencing any difficulty raising capital,[44] as evidenced by its ability to recently issue $800 million in 10-year and 30-years notes with a yield of 2.625 and 3.375 percent, respectively.[45] Based on these admissions, there is no justification for a size adjustment to ROE.

21. Atmos has not met its burden to demonstrate its existing 9.1% ROE is hindering its ability to raise capital, or insufficient to ensure the utility's financial integrity under proper management.

22. At the same time, CURB's recommended ROE range of 7.50% to 8.70% strikes the Commission as too low. Woolridge's recommended ROE is significantly below Atmos's current

[39] Tr., Vol. 1, pp. 86-87.
[40] *Id.*, p. 93.
[41] Gatewood Direct, p. 24.
[42] *Id.*, p. 103.
[43] *Id.*, p. 217.
[44] *Id.*
[45] *Id.*, p. 218.

authorized ROE and is even further below the average rates of return being allowed to natural gas utilities. As D'Ascendis testified, since 2018, the average and median authorized ROEs for natural gas utilities are 9.63% and 9.7% respectively.[46]

23. An ROE of 9.1%, as recommended by Staff, is below that requested by Atmos, and above that recommended by CURB. The current Baa Corporate Bond yield of 4.5%[47] is actually lower than the 4.89% yield in place during the 14-ATMG-320-RTS Docket, (the last time the Commission set Atmos's ROE).[48] Since capital costs have declined since the Commission set the 9.1% ROE, the 80 basis points increase sought by Atmos is not justified. Having reviewed the evidence provided by D'Ascendis, Woolridge, and Gatewood, the Commission believes an ROE of 9.1% strikes the proper balance of allowing Atmos to access capital markets while acknowledging the economic impact of higher ROEs on ratepayers.

B. CAPITAL STRUCTURE

24. D'Ascendis recommends using Atmos's actual capital structure as of March 31, 2019 to develop the overall rate of return.[49] Therefore, he proposes a capital structure consisting of 39.88% long-term debt and 60.12% common equity.[50] D'Ascendis testified that since a 60.12% equity ratio is within the range of common equity ratios of other utility proxy group members, it would be inappropriate to substitute a hypothetical capital structure.[51]

25. Both Staff and CURB recommend a capital structure of 43.68% long-term debt and 56.32% common equity.[52] Woolridge testified that Atmos's proposed capital structure has more equity than the rest of the gas proxy members and should be adjusted to reflect the issuance of

[46] D'Ascendis Rebuttal, p. 47.
[47] Gatewood Direct, p. 32.
[48] *Id.*, p. 30.
[49] D'Ascendis Direct, p. 10.
[50] *Id.*
[51] *Id.*, p.21.
[52] Gatewood Direct, p. 17; Woolridge Direct, p. 24.

$800 million in senior notes on October 2, 2019.[53] Gatewood agrees that Atmos's proposed capital structure should be adjusted to reflect Atmos's issuance of $800 million in unsecured debt.[54] As Gatewood explained, the new debt issuance increases the balance of Atmos's long-term debt by 22% and since the debt bears a lower interest rate than the interest rate from the test-year, a lower rate of return is appropriate.[55] Gatewood testified that since Atmos has already issued the debt, adjusting its capital structure to reflect the debt is known and measurable and presents a better estimate of Atmos's actual costs going forward.[56]

26. On rebuttal, D'Ascendis argued that if the Commission elects to update the capital structure for post-test year events, it should also adjust the capital structure for all known and measurable post-test year events, including Atmos's two planned equity issuances in 2020, which would result in a capital structure of 58.22% common equity and 41.78% long-term debt.[57] Both Staff and CURB oppose including Atmos's planned 2020 equity issuances in the capital structure. CURB explains that those issuances were not raised in the evidentiary hearing and are not known and measurable.[58] Staff notes the adjustment related to the 2020 issuances is over a year removed from the test year and is not known and measurable.[59]

27. Atmos's concerns that factoring in the 2019 issuances, but not the planned 2020 offerings, would violate the principles of synchronization are not compelling. As Staff points out, all of the other adjustments, including those to plant in service and payroll, are not updated beyond September 30, 2019.[60] Staff argues the Commission should not adopt capital structure that was

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[53] *Id.*, p. 23.
[54] Gatewood Direct, p. 17.
[55] *Id.*
[56] *Id.*
[57] D'Ascendis Rebuttal, p. 14; Post Hearing Brief of Atmos Energy Corporation (Atmos Brief), Jan. 3, 2020, ¶ 23.
[58] Post-Hearing Brief of the Citizens' Utility Ratepayer Board (CURB Brief), Jan. 15, 2020, ¶ 26.
[59] Staff Brief, ¶ 40.
[60] *Id.*, ¶ 42.

updated during the hearing, including projected equity issuances that will not be finalized until 2020, and would not be synchronized with all of the other major elements of Staff's revenue requirement.[61] The Commission agrees.

28. Based on Gatewood's testimony that Atmos used the 2019 new debt to refinance existing short-term debt, rather than replacing long-term debt already accounted for in its long-term debt balances in the test year,[62] the Commission concludes the new debt is not be used to finance new plant and equipment outside of staff's update cutoff.

29. Including the new debt incurred in October 2019 has a significant effect on the Atmos's annual Gas Safety & Reliability Surcharge (GSRS) calculations, which are dependent on the rate of return set in this Docket.[63] Accordingly, failure to include the new debt from 2019 would result in customers paying higher GSRS charges based on an inflated rate of return.[64] This would result in shareholders, rather than customers receiving the benefit of cost savings from the new debt incurred in 2019.[65] Staff's recommended capital structure is within the 50% to 60% equity ratio range targeted by Atmos management.[66] Staff's proposed capital structure is within the range approved in Atmos's other divisions.[67] Therefore, the Commission approves the capital structure of 43.68% long-term debt and 56.32% common equity recommended by Staff and CURB. The parties agree that a 4.37% embedded debt cost is appropriate in this proceeding.[68] Accordingly, the Commission adopts a 4.37% debt cost in this proceeding.

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[61] *See id.*
[62] Gatewood Direct, p. 18.
[63] Staff Brief, ¶ 36.
[64] *Id.*
[65] *Id.*
[66] *Id.*, ¶ 37.
[67] *Id.*, ¶ 38.
[68] Atmos Brief, p. 12, n. 27.

C. SYSTEM INTEGRITY PLAN (SIP)

30. Atmos proposes a five-year pilot, SIP tariff to allow it to accelerate its replacement of obsolete materials in its Kansas underground pipes.[69] In its Post Hearing Brief, Atmos characterizes its proposed SIP as "essentially the same SIP mechanism agreed to by Atmos Energy, Staff, and CURB in Atmos Energy's last general rate case proceeding in the [16-ATMG-079-RTS] docket with one exception; the stipulated SIP in the 079 docket provided for a semi-annual rather than quarterly rate adjustments"[70] That characterization is misleading.

31. On cross-examination, Gary W. Gregory, Atmos's President of its Colorado and Kansas Division, admitted that the current SIP proposal does not include a $75 million cap over five years that was part of the SIP mechanism proposed in the 16-ATMG-079-RTS Docket (16-079 Docket).[71] Similarly, Gregory acknowledged the current SIP proposal does not include the three-year rate moratorium that was a condition of the SIP mechanism from the 16-079 Docket.[72]

32. In 2008, Kansas enacted a monthly Gas System Reliability Surcharge (GSRS) charge to allow natural gas utilities to invest in system integrity and to assist in complying with federal and state safety standards.[73] In 2018, the Kansas Legislature amended the Gas Safety and Reliability Policy Act, doubling the maximum monthly Gas System Reliability Surcharge (GSRS) charge on residential customers from $0.40 to $0.80.[74]

33. Atmos contends that the GSRS process produces an 11-month capital investment lag and does not cover the entire cost of investment for system integrity.[75] Therefore, Atmos believes a SIP mechanism is necessary. Both Staff and CURB oppose the proposed SIP. As Staff

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[69] Application, ¶ 8.
[70] Atmos Brief, ¶ 31.
[71] Tr., Vol. 2, p. 257.
[72] *Id.*, p. 264.
[73] Direct Testimony of Gary L. Smith (Smith Direct), June 28, 2019, p. 9.
[74] K.S.A. 66-2204(e)(1); *See also* Smith Direct, p. 9.
[75] Smith Direct, p. 9.

witness Justin Grady testified, Atmos is fully recovering its investments in safety and reliability infrastructure today through the newly expanded GSRS.[76]

34. Staff recommends modifications to Atmos's proposed SIP: (1) capping the recovery of costs of incremental capital improvement at $50 million over five years; (2) beginning on January 1, 2021, and expiring on December 31, 2025; (3) requiring Atmos to file detailed annual SIP Plan Filings to be ruled on by the Commission each November 1; (4) requiring Atmos to make an annual surcharge filing by January 15, each year, with the first being due January 15, 2022; (5) providing only a return on and a return of capital expenditures above the $22 million per year in base safety, reliability, and GSRS-eligible capital expenditures; (6) requiring Atmos to file to renew, amend, or end the program by December 31, 2024; and (7) be accompanied by a three-year rate moratorium.[77]

35. Similarly, CURB explained it would be more amenable to the SIP if it would be: (1) used only after its GSRS is exhausted; (2) used only after taking advantage of depreciation; (3) limited to replacing cast iron or base steel pipeline; (4) updated annually; (5) limited to the monthly surcharge on residential customers to $0.40 per month; and (6) accompanied by a three-year rate moratorium.[78] The major difference between Staff's and CURB's proposed modifications is the size of cap.[79] Staff proposes a $50 million cap over the five-year pilot program, where CURB's proposal to limit the monthly surcharges equates to roughly a $35 million cap over the five-year period.[80]

[76] Direct Testimony of Justin T. Grady, Nov. 4, 2019, p. 15.
[77] *Id.*, pp. 28-29.
[78] CURB Brief, ¶ 40.
[79] *Id.*, ¶ 41.
[80] *Id.*

36. In its Reply Brief, Atmos continues to misstate the character of its proposed SIP. Atmos makes the remarkable claim that, "[f]rom the Company's perspective, it proposed a SIP tariff that was virtually identical to the tariff agreed to between Atmos Energy, Staff, and CURB in the last Atmos Energy rate case and supported by the Staff and the Company in the 343 docket. The only difference is that Atmos Energy proposed a quarterly surcharge mechanism in this docket rather than a semi-annual surcharge mechanism."[81] Atmos then offers up a revised SIP that was not presented to the Commission until after the evidentiary hearing.

37. Under its revised SIP, Atmos proposes a semi-annual surcharge mechanism with a $35 million cap over five years.[82] Atmos's revised SIP appears to address the vast majority of both Staff's and CURB's concerns. The only matter remaining in dispute is the timing of the surcharge. By proposing a semi-annual mechanism, Atmos appears to abandon its initial request for a quarterly surcharge mechanism. At the very least Atmos's proposal proves it does not believe a quarterly surcharge is necessary. Atmos offers no evidence to support a semi-annual surcharge. Instead it simply states, "both Staff and Atmos Energy indicated they could live with a semi-annual surcharge mechanism which was the arrangement incorporated into the 079 settlement."[83] That statement does not provide sufficient justification for the Commission to adopt a semi-annual surcharge. Nor does it recognize the important elements of the 16-079 Docket settlement still missing from Atmos's proposal, notably a three year rate moratorium. Therefore, even though the 16-079 Docket settlement contained a semi-annual surcharge, that is not compelling evidence that a SIP should be collected on a semi-annual basis.

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[81] Reply Brief of Atmos Energy Corporation (Atmos Reply Brief), Jan. 24, 2020, ¶ 19.
[82] *Id.*, Attachment A, p. 1.
[83] Atmos Reply Brief, p. 18.

38. Both Staff and CURB have supported an annual surcharge. Staff's and CURB's recommendations are supported by testimony from Justin Grady and Josh Frantz respectively. Furthermore, an annual surcharge is consistent with how the GSRS is collected. An annual surcharge is also less burdensome for the Commission and its Staff to administer. Since there is no evidence to support Atmos's revised semi-annual surcharge, and based on Atmos's acknowledgment that if the SIP mechanism was denied, it would continue to use the existing rate recovery options, such as the GSRS or rate cases, and more importantly, it would continue to spend and invest in its system and address safety issues without any pause, the Commission denies Atmos's proposed, modified SIP.

39. Both Staff and Atmos favor increasing the pace for replacing obsolete infrastructure.[84] The real dispute between the Staff and Atmos is the method of cost recovery.[85] The Commission is not opposed to a SIP in principle, just the SIP as originally proposed by Atmos. The Commission recognizes the urgent need to replace obsolete pipes, primarily bare steel and cast iron. Therefore, the Commission would approve the amended SIP proposed by Atmos in its Reply Brief, provided it includes: (1) an annual surcharge as suggested by CURB and Staff for replacing obsolete pipes, primarily bare steel and cast iron, and (2) is available only after its GSRS is exhausted; and (3) Atmos accepts a three-year rate moratorium. If after exhausting its GSRS, Atmos wishes to pursue a SIP including a $35 million cap over five years, with an annual surcharge, and a three-year rate moratorium, the Commission urges Atmos to collaborate with CURB and Staff to make a compliance filing, in accord with these conditions through a SIP tariff.

[84] *Id.*, p. 280.
[85] *Id.*, p. 281.

D. INCENTIVE COMPENSATION

40. Atmos claims its employee compensation plan supports and rewards high-performance by its employees, which benefits all stakeholders.[86] Staff recommends removing 100% of Atmos's short term Management Incentive Plan expenses, 50% of the time lapse portion of the Long Term Incentive Plan, and 100% of the expense associated with the Performance Based portion of the Long Term Incentive Plans allocated to Atmos's Kansas operations.[87] CURB recommends removing 100% of Atmos's compensation expenses beyond base salary.[88] Atmos contends that because its total compensation for employees (base pay plus incentive pay) is prudent and reasonable based upon those total salaries being below or at the total salaries paid in the market for similar positions, they should be recovered in rates.[89]

41. Atmos retained James F. Reda, who filed rebuttal testimony on the reasonableness of Atmos's total compensation levels, the competitiveness of Atmos's total compensation program, and the inclusion of incentive compensation in Atmos's cost of service.[90] In his prefiled rebuttal testimony, Reda states that Atmos's compensation levels compare favorably with the competitive market.[91] He reaches that conclusion because Atmos's compensation programs are at the 50th percentile of the marketplace and the incentive programs are tied to financial performance, which benefits all stakeholders.[92]

42. Despite Reda's concern that Atmos would not be able to retain qualified employees without its executive compensation program, on cross-examination, Reda admitted he did not conduct any studies on whether Atmos's ability to attract capital would be affected if the

[86] Atmos Post Hearing Brief, ¶ 51.
[87] Staff Brief, ¶ 86.
[88] CURB Brief, ¶ 75.
[89] Atmos Brief, ¶ 43(c).
[90] Rebuttal Testimony of James F. Reda, Nov. 18, 2019, p. 3.
[91] *Id.*, p. 8.
[92] *Id.*, p. 28.

Commission disallowed the incentive compensation programs in rates.[93] Similarly, he failed to conduct any surveys of Atmos executives to measure potential turnover if the Commission disallowed the incentive compensation programs in rates.[94]

43. Furthermore, even if the Commission excludes Atmos's compensation plans from rates, the evidence suggests Atmos's shareholders will gladly finance those programs. In his prefiled rebuttal testimony, Reda notes that in 2018, 94% of Atmos's shareholders approved the Company's compensation structure.[95] He argues the shareholder approval demonstrates the executive compensation structure adds value to shareholders and customers.[96] But when asked during cross-examination whether he believes the shareholders vote was influenced by whether they expect ratepayers to bear those costs, Reda answered no.[97] Likewise, when asked if he thought shareholders were concerned with who might be paying for these plans, he again answered no.[98] This is despite the evidence in the record that most of Atmos's jurisdictions disallow some portion of incentive compensation.[99] Therefore, Atmos's own expert implicitly acknowledges that its shareholders are willing to bear the cost of the incentive programs. Accordingly, there is no reason to burden ratepayers with costs, as shareholders have shown are perfectly willing to fund the incentive programs. If shareholders pay for the incentive programs, the incentive programs will continue to allow Atmos to recruit and retain valued employees.

44. Staff does not claim Atmos's compensation levels are unreasonable or imprudent; instead Staff believes Atmos's compensation metrics are too heavily weighted towards its financial

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[93] Tr., Vol. 3, p. 549.
[94] *Id.*, p. 550.
[95] Reda Rebuttal, p. 4.
[96] *Id.*
[97] Tr. Vol. 3, p. 551.
[98] *Id.*, p. 552.
[99] Tr., Vol. 3, p. 556.

goals.[100] Staff relies on the Commission's Order in the 10-415 Docket, where the Commission announced its intent to exclude programs that focus on the financial aspect, rather than operational aspects of the business,[101] to argue Atmos's programs should be disallowed. According to Staff, since the 10-415 Docket was issued, the Commission has repeatedly affirmed its decision, notably in the 12-KCPE-764-RTS Docket (12-764 Docket).[102] Therefore, Staff believes the policy to disallow incentive programs that focus on the financial benefits to the utility is settled law.[103] Atmos disagrees.

45. CURB recommends disallowing all incentive compensation expenses over and above base pay, including the financial portion of incentive compensation expenses for non-management employees.[104] In both the 10-415 and 12-764 Dockets, the Commission explicitly rejected CURB's more aggressive incentive compensation argument.[105]

46. The Commission concludes there is no reason to revisit its prior decisions on incentive compensation. Likewise, the Commission concludes there is no reason to revisit its decision announced in the 10-415 Docket to disallow incentive programs that focus on the financial aspect, rather than operational aspects. Accordingly, the Commission reaffirms its intent to disallow the costs of management incentive programs that focus on financial criteria. The Commission adopts Staff's recommendation to remove 100% of Atmos's short term Management Incentive Plan expenses, 50% of the time lapse portion of the Long Term Incentive Plan, and 100% of the expense associated with the Performance Based portion of the Long Term Incentive Plans

[100] Tr. Vol. 3, p. 655.
[101] Direct Testimony of Kristina A. Luke-Fry, Oct. 31, 2019, p. 19.
[102] *Id.*
[103] Staff Brief, ¶ 90.
[104] CURB Brief, ¶ 75.
[105] *See* Order on KCP&L's Application for Rate Change, Docket No. 12-KCPE-764-RTS, Dec. 13, 2012, ¶ 47.

allocated to Atmos's Kansas operations. Pursuant to K.S.A. 77-415(b), the Commission designates this paragraph as precedential.

E. DEPRECIATION

47. There are three primary issues related to the testimonies of each party - net salvage, service lives and depreciation calculation procedure.[106] Ned Allis prepared a depreciation study for Atmos.[107] The study is based on the Equal Life Group (ELG) procedure, which differs from the Average Life Group (ALG) procedure, currently used to calculate depreciation rates for Atmos.[108] Staff witness Roxie McCullar believes the ALG procedure should continue to be used to calculate depreciation rates for Atmos.[109] Additionally, McCullar recommends adjustments to several of Atmos's proposed net salvage rates.[110] McCullar's adjustments would reduce Atmos's proposed Depreciation Rate and Expenses by $2,622,802.[111]

48. CURB's witness, James Garren, proposes lower depreciation rates than Allis due to adjustments to the average service lives used to calculate depreciation rates for seven distribution accounts; and a proposed alternative method of estimating future net salvage, based on the most recent five-year history of the Company's net salvage experience.[112] Garren expresses concerns with Allis's methodology: (1) it produces unrealistically high future net salvage ratios; and (2) second, because net salvage and retirements are not causally related or mathematically correlated in any way, relying on this ratio yields unreliable and unsound results.[113] Therefore, Garren proposes a methodology which utilizes the most recent five-year average of net salvage to

[106] Rebuttal Testimony of Ned W. Allis (Allis Rebuttal), Nov. 18, 2019, p. 1.
[107] Direct Testimony of Ned W. Allis (Allis Direct), June 28, 2019, p. 1.
[108] *Id.*; Staff Brief, ¶ 106.
[109] Direct Testimony of Roxie McCullar (McCullar Direct), Oct. 31, 2019, p. 2.
[110] *Id.*, p. 11.
[111] *Id.*, p. 3.
[112] Direct Testimony of James S. Garren (Garren Direct), Oct. 31, 2019, p. 4.
[113] *Id.*

estimate future net salvage.[114] He estimates total future net salvage by multiplying the annual accrual requirement by the account remaining life.[115] Garren's adjustments would reduce Atmos's proposed Depreciation Rate and Expenses by $2,973,248.[116]

Net Salvage

49. Net salvage is gross salvage less cost of removal.[117] Net salvage is normally negative because cost of removal is typically greater than gross salvage for most accounts.[118] Depreciation rates are designed to recover future net salvage, not what has been recorded in the past.[119] Atmos, Staff, and CURB all propose different net salvage figures.

50. Allis proposes a methodology that calculates a ratio of annual net salvage over retirements, where he examines this ratio in five and ten year periods over the past fifteen years, and factors in the historical data, the age of the plant, managerial expectations, and the experience of other utilities in the industry, to arrive at a net salvage ratio for each account.[120]

51. On rebuttal, Allis claims Staff's and CURB's proposals rely almost entirely on historical data, compared to Atmos's forward looking proposals.[121] Allis accuses Staff and CURB of proposing alternatives that do not fully estimate future net salvage.[122] He argues that unlike Atmos, who has used the industry standard method of estimating future net salvage, Staff and CURB offer methodologies, which have no support from depreciation authorities and which at most have limited acceptance by regulatory commissions.[123] Allis contends that by failing to

[114] *Id.*, p. 34.
[115] *Id.*
[116] *Id.*, p. 36.
[117] Atmos Brief, ¶ 25.
[118] Allis Rebuttal, pp. 6-7, Garren Direct, p. 6.
[119] Allis Direct, pp. 13-14.
[120] Garren Direct, p. 27.
[121] Allis Rebuttal, pp. 1-2.
[122] *Id.*, p. 2.
[123] *Id.*

recover net salvage over the lives of the Company's assets, Staff's and CURB's proposals will produce intergenerational inequity, particularly as Atmos's accelerated pipe replacement program results in higher levels of net salvage.[124]

52. Atmos claims its uses the industry-standard method for analyzing net salvage is to express net salvage (and its components cost of removal and gross salvage) as a percentage or ratio of retirements,[125] whereas CURB's and Staff's methodologies consider the level of net salvage recorded in recent years, not as a percentage of retirements.[126]

53. As the Applicant, Atmos bears the burden of proof on all issues, including depreciation. The record contains several competing expert claims as to the correct methodology for determining the proper net salvage level, and Atmos is unable to prove that its methodology is the *only* methodology that will result in just and reasonable rates. While Atmos claims its methodology is superior to Staff's and CURB's, Atmos's net salvage estimates are not based purely on statistical analyses or historical net salvage amounts expressed as a percentage of retirements. As Allis states in his Direct Testimony, "the net salvage percentages in the Depreciation Study are based on a combination of statistical analyses and informed judgment."[127] Staff's depreciation witness McCullar testifies similarly, "[m]y proposed future net salvage accrual amounts are in current dollars that consider Atmos's historic practices, the impact of inflation, and builds a reserve for reasonable estimated future net removal costs associated with future retirements, based on the type of investments in the account, and my previous experience."[128]

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[124] *Id.*
[125] Atmos Reply Brief, ¶ 28.
[126] *Id.*, ¶ 30.
[127] Allis Direct, p. 14.
[128] McCullar Direct, p. 12.

CURB's depreciation witness Garren, stands alone making a recommendation based strictly on the most recent five year average of net salvage.[129]

54. After examining the evidence on the issue of net salvage, the Commission is not convinced that it must adopt a particular methodology as the only "right" approach in this Docket. However, the Commission rejects CURB's methodology because it relies solely on recent historical net salvage experience. Although their methods of determining net salvage differ, Atmos, Staff, and CURB agree that the purpose of a net salvage analysis is to estimate the future level of net salvage that Atmos will incur as part of its depreciation expense. Both Staff and Atmos agree that a net salvage analysis should estimate appropriate levels of future net salvage, not solely rely strictly on historic expense levels. When deciding between Atmos and Staff's net salvage analyses, the Commission finds Staff's approach will best balance the interests of Atmos's current versus future ratepayers. Again, this finding is not based on adopting any particular methodology in this Docket, but that Staff's approach strikes the best balance between current and future ratepayers.

Service Lives

55. On the issue of the appropriate service life estimates for Atmos's assets, Staff and Atmos utilize the same service lives,[130] but CURB recommends longer service lives for seven accounts.[131] Allis claims CURB's proposals are not based on sound methodology and are not consistent with the recommendations of depreciation authorities.[132] Atmos also contends CURB's

[129] Garren Direct, p 34.
[130] *Id.*, pp. 2-3.
[131] *Id.*, p. 3.
[132] *Id.*

service life proposals do not account for accelerated modernization of infrastructure.[133] Finally, Atmos asserts CURB's approach conflicts with NARUC's guidance on the issue.[134]

56. The Commission agrees with Atmos that Atmos's service life proposals are consistent with both the need to accelerate the modernization of infrastructure, and with the recommendations of depreciation authorities such as NARUC. Therefore, the Commission accepts Atmos's proposed service lives as agreed to by Staff.

ELG versus ALG

57. On the question of whether to use the ELG or ALG procedure, Allis dismisses CURB's position as lacking any support, and Staff's arguments as not standing up to scrutiny.[135] While both ALG and ELG procedures are calculated to recover 100% of the original cost over the life of the plant, the ELG procedure should be adjusted annually and is front-loaded.[136]

58. Atmos acknowledges that adopting Staff's and CURB's recommendations to increase the lives of existing assets and decrease depreciation expense certainly achieves any short-term policy or goal of maintaining lower customer rates, as depreciation expense is the largest revenue requirement adjustment in this rate case.[137]

59. In its Reply Brief, Atmos argues that just because ELG produces higher depreciation rates does not mean that it is unjust and unreasonable and that ALG results in too low of depreciation rates in the early years of the life of property.[138] In doing so, Atmos has not demonstrated the Commission should change from its current process of applying the ALG

[133] Atmos Reply Brief, ¶ 42.
[134] *Id.*, 45.
[135] *Id.*
[136] McCullar Direct, p. 6.
[137] Atmos Brief, ¶ 42.
[138] Atmos Reply Brief, ¶ 52.

procedures to depreciation rates. Therefore, the Commission declines to deviate from the existing process. The Commission will apply ALG procedures to calculate Atmos's depreciation rates.

F. RATE CASE EXPENSE

60. The Parties agree that utilities are entitled to recover prudently incurred rate case expenses through rates.[139] Staff questions the costs associated with Reda's testimony regarding Atmos's incentive compensation plan and with Quackenbush's testimony regarding the proposed SIP.[140] CURB recommends allowing Atmos to collect its reasonable rate case expense through a three-year normalization.[141] CURB does not define what it considers reasonable rate case expense.

61. Atmos contends it would benefit the Commission to hear the perspective of someone from outside Atmos, who could provide a broader look at SIP-like mechanisms.[142] Therefore, Atmos believes the expenses of Quackenbush, a former regulator who had approved similar mechanisms, are justified for inclusion in rates.[143] The Commission disagrees.

62. As Quackenbush readily admits, he provides testimony on what other states have allowed for ROEs based on RRA reports.[144] He acknowledges that RRA's evaluation are from the perspective of investors.[145] Quackenbush's testimony is premised on his knowledge garnered as a former Michigan Commissioner. Expert testimony is proper if it will be of special help to the factfinder on technical subjects with which the factfinder is not familiar or if it would assist the factfinder in reaching a reasonable factual conclusion.[146] The Commission is capable of interpreting the RRA ratings without the aid of expert testimony. Furthermore, Quackenbush's

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[139] Rebuttal Testimony of Jennifer K. Story, Nov. 18, 2019, p. 28; Direct Testimony of Ian D. Campbell, Oct. 31, 2019, p. 6.
[140] Staff Brief, ¶ 163.
[141] CURB Brief, ¶ 101.
[142] Atmos Brief, ¶ 72.
[143] *Id.*
[144] Tr., Vol. 1, p. 210-211.
[145] Quackenbush Rebuttal, p. 15.
[146] *Sterba v. Jay*, 249 Kan. 270, 282 (1991).

testimony substantially overlaps with that of Gary L. Smith and Gary W. Gregory. Under these circumstances, Quackenbush's testimony has little probative value, therefore, the Commission disallows his expenses from rate case expense.

63. Atmos believes Reda's testimony is necessary to show the reasonableness of total compensation paid to Atmos's employees based upon what similar employees are paid in the market.[147] In addition, since Staff did not question the reasonableness of similar testimony in the recent Kansas Gas Service rate case, Atmos assumed Reda's costs were prudently incurred.[148] Staff counters by explaining that Reda's compensation is significantly higher than his counterpart in the Kansas Gas Service rate case.[149] As Justin Grady testified, Kansas Gas Service spent \$42,590 on an external consultant for incentive compensation; whereas Atmos spent \$79,000, nearly double the amount incurred by Kansas Gas Service.[150] Subsequently, on February 14, 2020, Atmos updated its estimated rate case expense, upping Reda's expenses to \$91,368.[151] Reda's expenses are higher than either of the outside attorneys that tried this case and higher than its ROE witness. ROE is a much larger financial piece of Atmos's rate case than incentive compensation.

64. Grady also questions the need for Reda's testimony because he believes Atmos could have used internal employees as it did in its last rate case to testify on incentive compensation.[152] Since Staff's treatment of incentive compensation expense has been consistent since the 10-415 case, Grady sees no need for Atmos to incur the cost of an outside expert on incentive compensation.[153] Grady notes that Gary Gregory is already a witness in this matter and

[147] Atmos Brief, ¶ 71.
[148] *Id.*
[149] Staff Brief, ¶ 163.
[150] Tr., Vol. 2, p. 483.
[151] Estimated Rate Case Expense, Feb. 14, 2020, p. 1.
[152] Tr., Vol. 2, p. 482.
[153] *Id.*

that Barbara Myers, who is listed by Atmos on its rate case exhibit list as a manager of this filing, and has previously provided testimony on this topic, could have also testified in lieu of Reda.[154]

65. Reda did not prepare any studies for Atmos. Instead, he just reviewed two studies prepared by Pay Governance LLC for the Atmos Energy Board of Directors Human Resources Committee.[155] Both studies conclude that Atmos's total direct compensation levels were at or below the 50th percentile compared to its peer group and published survey data.[156] Since both studies were presented to Atmos back in October 2018,[157] the Commission questions the need to retain Reda to testify on these studies. Despite the Commission's concerns, since Atmos bears the burden of proof, it is entitled to pick a witness it believes will best present its case. Also, since the Commission did not disallow any rate case expense relating to incentive compensation in the recent Kansas Gas Service rate case,[158] it will not disallow all of Reda's expenses. While the Commission elects not to disallow all of Reda's expenses, it finds his expenses excessive and duplicative. Compared to the expenses incurred by Kansas Gas Service and also the expenses incurred by both Atmos's outside attorneys and Atmos's ROE witness, Reda's expenses are excessive. For these reasons, the Commission disallows half ($45,684) of Reda's expenses.

66. Atmos seeks to recover its rate case expense through a one-year surcharge on customer bills, but is willing to agree to a two-year recovery period.[159] CURB recommends allowing Atmos's rate case expenses to be recovered through a three-year normalization of those costs in base rates.[160] Staff opposes Atmos's proposed rate case expense surcharge because it

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[154] *Id.*
[155] Reda Rebuttal, p. 8.
[156] *Id.*, p. 9.
[157] *Id.*, p. 8
[158] *See* Tr., Vol. 2, p. 488.
[159] Atmos Brief, ¶ 73.
[160] CURB Brief, ¶ 101.

believes it will reduce Atmos's incentive to prudently manage its rate case expenses and because it would allow Atmos to recover its rate case expense too quickly.[161]

67. In Atmos's most recent rate case, the Commission ordered it to amortize its rate case expense over three years.[162] Atmos has not provided sufficient justification to change course. Therefore, the Commission finds Atmos should amortize its rate case expense over three years.

G. MONTHLY RESIDENTIAL CUSTOMER CHARGE

68. Currently, Atmos residential customers are charged a monthly fixed charge of $18.04 per month, in addition to paying for the volume of gas they use.[163] Atmos is seeking to increase the monthly fixed charge to $22.00.[164] Staff proposes a smaller increase to $18.89.[165] CURB recommends decreasing the monthly charge to $15.00.[166] CURB arrives at the $15.00 figure by performing a direct customer cost analysis,[167] which produces a residential direct customer cost in the range of roughly $9-$10.[168] Because the current fixed monthly charge is $18.04, CURB witness Watkins considers it excessive.[169] But Watkins stops short of recommending setting the fixed monthly charge at $10 because of gradualism and his assumption that the Commission will want to include some overhead expenses in the fixed charge.[170] Due to those two considerations, Watkins recommends a $15 customer charge.[171] On cross-examination,

[161] Staff Brief, ¶ 159.
[162] *Id.*, ¶ 160.
[163] The Commission approved a residential fixed charge of $18.91 in Atmos's last rate case, Docket No. 16-ATMG-079-RTS. The $18.91 was reduced to $18.04 due to tax reform and further reduced to $17.72 for the period of April 2018-March 2019, due to the deferred revenue credit. Direct Testimony of Robert H. Glass, Ph.D. (Glass Direct), Oct. 31, 2019, p. 10, Table 4.
[164] Atmos Brief, ¶ 74.
[165] Staff Brief, ¶ 166.
[166] CURB Brief, ¶ 102.
[167] Tr. Vol. 3, p. 660.
[168] *Id.*, p. 661.
[169] *Id.*, p. 662.
[170] *Id.*
[171] *Id.*

Watkins acknowledges that shifting some costs from the fixed monthly charge to a volumetric charge could result in higher bills in cold weather.[172]

69. Atmos witness Paul H. Raab expresses his concern that Atmos faces a significant risk when it has to try to collect fixed costs through volumetric charges[173] because the costs remain fixed and Atmos may not collect enough revenues to meet its authorized rate of return.[174] Dr. Robert H. Glass, the Commission's Chief of Economics and Rates, testified that Atmos is best situated among gas utilities operating in Kansas because it is experiencing customer growth and has a weather normalization adjustment (WNA), which in addition to the weather normalization of the revenue requirement, protects Atmos from weather fluctuations,[175] and therefore, Atmos, should not require a higher customer charge.[176]

70. In Atmos's last rate case, Staff attempted to slow the trend of rising fixed monthly charges, where the fixed charges have increased at a greater rate than the commodity charge.[177] At the same time, Staff acknowledges that fixed costs should be recovered through fixed charges.[178] During the test year, 64% of the residential base rate revenue came from fixed charges.[179] CURB argues that by collecting roughly two-thirds of its residential base rate revenue through fixed charges, Atmos inhibits residential customer's ability to control their bills through conservation.[180]

71. The Commission concludes that an increase of the fixed monthly charge is not warranted based on Atmos's WNA and increasing customer base. At the same time, the

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[172] *Id.*, p. 666.
[173] *Id.*, p. 678.
[174] *Id.*, p. 679.
[175] *Id.*, p. 686.
[176] *Id.*
[177] Glass Direct, p. 21.
[178] *Id.*
[179] *Id.*, p. 22.
[180] Direct Testimony of Glenn A. Watkins, Oct. 31, 2019, p. 27.

Commission is concerned that CURB's recommended $15.00 fixed monthly charge is not supported by competent evidence. The Commission finds that Staff's proposed $18.89 strikes the proper balance between allowing Atmos to collect its fixed costs and providing customers with some ability to manage their gas usage to lower their monthly bills. An $18.89 monthly charge is consistent with Kansas Gas Service's $18.70 and Black Hills Energy's $17.25.[181] Accordingly, the Commission adopts $18.89 as the monthly residential customer charge.

72. On the issue of weather normalization, Atmos agrees to accept Staff's WNA proposal. In doing so, Atmos expresses its desire to work with Staff to develop updated WNA tariffs and future WNA annual filings to incorporate the new classes and weather sensitivity factors.[182] Accordingly, the Commission directs the parties to jointly develop the updated WNA tariffs and future WNA annual filings to incorporate the new classes and weather sensitivity factors. The parties shall file a status update by June 1, 2020 outlining the proposed implementation process for Commission consideration.

H. OTHER RATE BASE AND INCOME STATEMENT ADJUSTMENTS

73. The Commission accepts the following uncontested accounting adjustments:

- Donation Expense (Staff IS-9) ($74,772)
- Other Postretirement Benefits (Staff IS-14) ($68,917)
- Interest on Customer Deposits (Staff IS-7) ($1,102)
- Advertising Expense (Staff IS-8) ($9,605)
- Pension Expense (Staff IS-13) ($65,132)
- Pension Tracker 1 and OPEB Tracker 1 (Staff IS-15) $98,094

[181] Tr. Vol. 3, p. 687.
[182] Rebuttal Testimony of Gary L. Smith, Nov. 18, 2019, p. 24.

- Leases (Staff IS-16) $76,517
- Weather Normalization (Staff IS-17) ($466,047)
- Customer Annualization (Staff IS-18) $119,039
- KCC Annual Assessment Expense (Staff IS-10) ($8,070)
- Customer Deposits (Staff RB-5) $40,502
- Prepayments (Staff RB-6) $62,178
- Storage Gas (Staff RB-7) $527,781

Construction Work in Progress (CWIP)

74. Atmos believes it should be allowed to include the CWIP balance of $1,620,606, in rate base because it has verified the listed projects will be completed and in service by no later than February 2020, within one year from the end of the test year.[183] CURB witness Andrea C. Crane does not believe most of the claimed CWIP were incurred before the end of the test year, and thus should be excluded from rate base.[184] CURB recommends including $1,307,897 of CWIP in rate base.[185] Staff recommends excluding all CWIP not closed to Plant in Service by August 31, 2019 from rate base.[186] Staff's adjustment would remove $11,110,143 from Atmos's rate base.[187]

75. Staff's review of Atmos's workpapers reveals Atmos missed the projected in-service date of approximately 55% of the projects it projected to be placed into service by September 30, 2019.[188] The only evidence that Atmos offers to suggest that projects were expected to be completed by February 2020 is hearsay testimony from Jennifer Story that Bart Armstrong

[183] Atmos Brief, ¶ 52.
[184] Direct Testimony of Andrea C. Crane (Crane Direct), Oct. 31, 2019, p. 11.
[185] *Id.*, p. 12.
[186] Staff Brief, ¶ 124.
[187] Direct Testimony of Brad Hutton, Oct. 31, 2019, p. 5.
[188] Staff Brief, ¶ 128.

verified that the projects listed on a worksheet would be completed by February.[189] Her testimony is not enough to demonstrate the listed projects will be in service by February 2020. Therefore, the Commission approves Staff's adjustment to remove $11,110,143 from Atmos's rate base.

Miscellaneous Expenses

76. Staff recommends disallowing $46,123 of miscellaneous expenses because those dues paid to professional organizations do not directly benefit ratepayers.[190] Atmos counters that only $29,047 should be disallowed because the cost of those licensing fees and membership dues are reasonable, Staff used an incorrect allocation factor, and Staff eliminated some legal expenses that Atmos did not include in its Application.[191] Staff claims to have corrected these errors in its final adjustments, which Atmos did not dispute.[192] Atmos did not present any evidence to rebut Staff's claim that the license fees and membership dues directly benefit ratepayers. Accordingly, the Commission adopts Staff's adjustment and disallows $46,123 of miscellaneous expenses because those dues paid to professional organizations do not directly benefit ratepayers.

Plant, Accumulated Depreciation, Accumulated Deferred Income Tax (ADIT), and Excess Deferred Income Tax (EDIT) Accounts

77. Atmos seeks to update Plant in Service to September 30, 2019, which would increase its rate base by $9,402,791.[193] Staff opposes updating Atmos's balances for Plant in Service beyond August 31, 2019, because nearly every other update to the test year is through August 30, 2019.[194] Staff's adjustment would increase Atmos's rate base by $7,840,069.[195] The

[189] Tr. Vol 2, p. 525.
[190] Staff Brief, ¶ 118.
[191] Atmos Brief, ¶ 64.
[192] Staff Brief, ¶ 119
[193] Atmos Brief, ¶ 55.
[194] Staff Brief, ¶ 131.
[195] *Id.*, ¶ 130.

Commission adopts Staff's adjustment as it more closely resembles Atmos's ongoing cost of doing business and is synchronized with the vast majority of other adjustments in this Docket.[196]

78. Staff advises that Plant in Service (and thus Depreciation Expense), ADIT, and Accumulated Depreciation need to be updated through the same date to avoid IRS Normalization Violations.[197] Therefore, the Commission finds that ADIT, Accumulated Depreciation, and Depreciation Expense should to be updated through August 31, 2019.

Accumulated Deferred Income Taxes (ADIT)

79. Staff proposed increasing ADIT by $1,081,792, which is an offset to Plant in Service, which decreases rate base.[198] Staff's adjustment is due to: (1) updating ADIT balances to update period of August 31, 2019; (2) remove ADIT associated with pension and FAS 106 costs; (3) remove ADIT associated with Regulatory Liability-Mid Tex; and (4) remove portions of ADIT corresponding to Staff's incentive compensation adjustment.[199] In acknowledging a difference in timing between the recovery of pension and post-retirement benefits in rates and the deduction for this amount on its tax return, Atmos claims that the timing difference is no different than any other timing difference for expense included in rates, and notes Staff has not made this adjustment in previous Atmos rate cases.[200] Atmos admits it mislabeled the Regulatory Liability-Mid Tex balance in its Application but argues that the balance should be included as an adjustment to rate base because it relates to pensions and post-retirement obligations.[201]

80. Staff claims its proposed adjustments to ADIT to remove the ADIT balances associated with pension expenses and FAS 106 costs are necessary to match up the removal of

[196] *See id.*, ¶ 132.
[197] Staff Brief, ¶ 141.
[198] *Id.*, ¶ 136.
[199] *Id.*
[200] Atmos Brief, ¶ 57.
[201] *Id.*, ¶ 58.

pension and FAS 106 costs from rate base.[202] Atmos has not effectively countered this rationale and Ms. Story admits that these balances are not in rate base.[203] Accordingly, the Commission accepts Staff's adjustments to ADIT for this issue. The remainder of Staff's adjustments to ADIT are consistent with its proposal to remove certain incentive compensation expenses from the revenue requirement.[204] Accordingly, since the Commission accepted Staff's proposal to remove certain incentive compensation expenses, it elects to adopt Staff's adjustments to ADIT.

<u>Excess Deferred Income Tax (EDIT)</u>

81. Staff recommends: (1) updating the level of EDIT amortization and Atmos's EDIT regulatory liability to reflect Atmos's most recent revisions to EDIT amounts; (2) removing portions of EDIT that correspond to equity compensation and incentive compensation amounts removed by Staff; and (3) amortizing the before-tax-gross-up EDIT balance to deferred tax expense, as in every single regulated utility rate case filed in Kansas since the implementation of the Tax Cuts and Jobs Act.[205] Staff recommends including $19,346,609 of EDIT regulatory liability and an EDIT amortization amount of ($711,062).[206] Atmos's only dispute with Staff's adjustment is its removal of certain EDIT amounts related to its incentive compensation adjustment. As the Commission has accepted Staff's incentive compensation adjustment, so too does it accept Staff's EDIT adjustment related to incentive compensation. Accordingly, the Commission adopts Staff's adjustments to EDIT.

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[202] Staff Brief, ¶ 139.
[203] Tr. Vol 2, p. 526.
[204] Atmos Brief, ¶ 59.
[205] Staff Brief, ¶ 133.
[206] *Id.*, ¶ 134.

Accumulated Depreciation

82. Staff recommends decreasing Atmos's Rate Base by $2,161,428 to reflect the balance of Accumulated Depreciation through Staff's update period ending August 31, 2019. Staff's proposed adjustment would synchronize the balance of Plant In Service and its corresponding Accumulated Depreciation balances.[207] This adjustment to Accumulated Depreciation ensures ratepayers are given credit for the capital they have returned to Atmos, and therefore, no longer need to pay a return on.[208] Atmos's dispute with Staff appears to revolve around the timing to update the balance. The Commission adopts Staff's adjustment to synchronize Plant In Service and Accumulated Depreciation as of August 31, 2019.

Bad Debt Expense

83. Staff proposes to decrease operating expenses by $27,838 to account for bad debt expense. Staff used a three-year average net bad debt write-off percentage of 0.4004% through year-end August 31, 2019.[209] CURB favors a normalization adjustment that accounts for multiple years and would decrease operating expense by $46,869 to account for bad debt expense.[210] Atmos disputes CURB's and Staff's adjustments. Atmos argues CURB's adjustments are inconsistent with previous Atmos rate cases and will preclude the Company from recovering its actual costs.[211] Other than alleging Staff's methodology of using a three-year average is not consistent with past Commission practice in Atmos dockets, Atmos does not present a compelling reason to reject Staff's adjustment. Therefore, the Commission adopts Staff's adjustment to bad debt expense.

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[207] *Id.*, ¶ 135.
[208] *Id.*
[209] *Id.*, ¶ 146.
[210] CURB Brief, ¶ 93; Crane Direct, Schedule ACC-12.
[211] Atmos Brief, ¶ 63.

Depreciation Expense

84. Staff proposes decreasing annualized depreciation expense by $2,413,239, by increasing Atmos' pro-forma depreciation expense by $303,708 for updates to Atmos' Plant in Service and decreasing Atmos' depreciation expense by $2,716,947 to reflect Staff's recommended depreciation rates.[212] Any adjustment to depreciation expense needs to be synchronized with the updated Plant in Service date.[213] Having already adopted a Plant in Service date of August 31, 2019, the Commission adopts the same date for depreciation expense. Additionally, the Commission ruled above that Atmos' depreciation expense should be calculated using Staff's recommended depreciation rates. Accordingly, the Commission approves Staff's adjustment for depreciation expense.

Payroll Expense and Benefit Expenses

85. Atmos agrees with Staff's recommendation to update payroll and employee benefits expenses through August 31, 2019, but complains Staff's adjustment only included 11 months of the merit increases.[214] CURB recommends increasing payroll expense by $67,818.[215] Atmos also disagrees with CURB's payroll tax adjustment, claiming it mistakenly assumes that taxes are paid at the statutory rates.[216] Atmos seeks to add a 0.25% (one-twelfth of 3%) of the annualized merit increase to Staff's adjustment, which would increase payroll expense by $96,868 and increase employee benefit expense by $30,456.[217]

86. The Commission rejects Atmos' approach to calculating a full 12 months of merit increase because it multiplies the full year of payroll expense by 1.5%, when half of the months in

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[212] Staff Brief, ¶ 150.
[213] *Id.*, ¶ 151.
[214] Atmos Brief, ¶ 60.
[215] CURB Brief, ¶ 92; Crane Direct, Schedule ACC-8.
[216] Atmos Brief, ¶ 60
[217] *Id.*

the test year already includes the potential 3.0% merit increase.[218] Additionally, Atmos's approach assumes that there are no hires, fires, or promotions since the test year. Staff's update, ending August 31, 2019, includes 12 months of actual known and measurable payroll expense that contains the changes to the test year payroll Atmos attempted to include in the cost of service. Accordingly, the Commission accepts Staff's adjustments.

87. Staff proposes decreasing operating expense by $202,065, by updating Atmos's benefits expense to account for actual expenses incurred by Atmos for the 12-months ending August 31, 2019.[219] CURB proposes a $26,847 increase in employee benefit expenses.[220] Atmos disputes CURB's adjustment to employee benefit expenses. The Commission rejects Atmos's adjustment because it is not based on actual known and measurable amounts, and is merely an estimate of how benefits expenses can change with changes to payroll expenses. Therefore, the Commission accepts Staff's adjustment which relies on known and measurable information, and more closely match Atmos's current cost of service.

<u>Lobbying/Membership dues/Meals & Entertainment/SERP expenses</u>

88. CURB asserts certain activities are not necessary for the provision of safe and adequate service and seeks to disallow up to 50% American Gas Association (AGA) dues expense not related to lobbying,[221] 50% of Atmos' request for meals and entertainment expenses not deducted from taxes,[222] and 100% of Atmos's supplemental executive retirement plan (SERP) expenses.[223] Staff does not contest Atmos's expenses in these areas. While K.S.A. 66-1,206(a) allows the Commission to disallow 50% of utility dues, donations and contributions to charitable,

[218] Staff Brief, ¶ 154.
[219] *Id.*, ¶ 157.
[220] Crane Direct, Schedule ACC-10.
[221] Atmos Brief, ¶ 65.
[222] CURB Brief, ¶ 100.
[223] Crane Direct, Schedule ACC-11.

civic and social organizations and entities, and not specific dues, donations and contributions which are found unreasonable or inappropriate, the Commission does not find that CURB has shown the challenged expenses are unreasonable or inappropriate. In addition, the Commission has already accepted Staff's adjustments to miscellaneous expenses, which removes various expenses that do not provide direct ratepayer benefits. Therefore, the Commission denies CURB's proposed adjustments for lobbying, membership dues, meals and entertainment, or SERP expenses.

Abbreviated Rate Case

89. Pursuant to K.A.R. 82-1-231(b)(3)(A), Atmos seeks to file an abbreviated rate case within 12 months of this Order.[224] The abbreviated rate case would be designed to update rates to reflect new non-growth revenue infrastructure investment that is not included in rates and is not eligible for recovery under Atmos's GSRS tariff or SIP tariff but will have been placed in service by the time the audit of the abbreviated filing is completed.[225] Staff argues because Atmos will fully recover its increase in safety, reliability, and GSRS-eligible Net Plant through the GSRS and SIP mechanism, an abbreviated rate case is unwarranted.[226] The Commission agrees. As discussed in paragraph 39, the Commission would approve a SIP with additional conditions, including a three-year rate moratorium. If Atmos elects to make a compliance filing with a SIP tariff, it will render its request for an abbreviated rate case moot. In the event that Atmos does not make a compliance filing, its request for an abbreviated rate case is denied.

90. Atmos requested a net revenue increase of $7,163,131. The Commission finds Atmos is entitled to a net revenue reduction of $223,953. Under Atmos's original request, the

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[224] Application, ¶ 9.
[225] *Id.*
[226] Staff Brief, ¶ 84.

average residential ratepayer's bill would have increased by $4.33 in winter months and $3.41 in summer months.[227] But under this Order, the average residential ratepayer's bill will only increase by $0.35 in winter months and $0.11 in summer months.[228] The slight increase in residential ratepayer's bills is designed to reduce the continued subsidization of the residential class, which represents about 72% of total base rate revenue collected,[229] by the commercial sales class, and bring the classes closer to parity.[230]

91. The Commission considered all of the evidence in the record and considered the positions and arguments of all the parties in making its findings and conclusions. The failure to specifically address a particular item, position, or argument offered into evidence does not indicate it was not considered by the Commission.

THEREFORE, THE COMMISSION ORDERS:

A. The Commission sets Atmos's overall revenue requirement based on an operating income of $14,780,974, a rate base of $242,313,526, a return on equity of 9.1%, and an overall rate of return of 7.03%. The Commission approves a base rate revenue requirement increase of $3,067,466. After accounting for the reduction of the GSRS charge by $3,291,419, the net impact on customers of this Order is a revenue requirement reduction of $223,953.[231]

B. Atmos's proposed SIP mechanism is rejected, but the Commission would approve a SIP tariff for a SIP with a $35 million cap over five years, and with an annual surcharge, three-year rate moratorium, and is available only after Atmos exhausts its GSRS, if sought by Atmos.

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[227] *See* Direct Testimony of Paul H. Raab (Raab Direct), June 28, 2018, p. 24.
[228] *See* Glass Direct, p. 26, Table 11.
[229] *Id.*, p. 19.
[230] *See id.*, p. 20; Raab Direct, p. 26.
[231] *See* Attachment A to the Order for an overview calculation of the revenue requirement increase.

C. Pursuant to K.S.A. 77-415(b), paragraph 46 of this Order is designated precedential. Accordingly, this Order will be included in the Commission's index of precedential orders, published on the Commission's website.

D. The corresponding rate increases shall be set in accordance with the Commission's Final Revenue Requirement Calculation, attached as Attachment A. The Commission's Final Revenue Requirement Calculation is based on Staff's filed schedules and revised in accordance with the Commission's decisions on the contested issues.

E. Any party may file and serve a petition for reconsideration pursuant to the requirements and time limits established by K.S.A. 77-529(a)(1).[232]

F. The Commission retains jurisdiction over the subject matter and parties to enter further orders as it deems necessary.

BY THE COMMISSION IT IS SO ORDERED.

Duffy, Chair; Albrecht, Commissioner; Keen, Commissioner

Dated: 02/24/2020

Lynn M. Retz

Lynn M. Retz
Executive Director

BGF

[232] K.S.A. 66-118b; K.S.A. 77-503(c); K.S.A. 77-531(b).

ATMOS ENERGY
COMMISSION ORDER
SUMMARY OF ADJUSTMENTS TO RATE BASE
FOR THE TEST YEAR ENDED MARCH 31, 2019

	DESCRIPTION	AMOUNT
RATE BASE PER APPLICANT		248,709,964
	ADJUSTMENTS TO RATE BASE ACCEPTED BY THE COMMISSION	
STAFF-1	Removal of Construction Work in Progress	(11,110,143)
STAFF-2	Update of Plant to August 31, 2019	7,840,069
STAFF-3	Update of Accumulated Depreciation to August 31, 2019	(2,161,428)
STAFF-4	Update of Accumulated Deferred Income Tax to August 31, 2019	(1,081,792)
STAFF-5	Update Customer Deposits to August 31, 2019	40,502
STAFF-6	Update Prepayments to a 13 month average ending to August 31, 2019	62,178
STAFF-7	Update Storage Gas balances to August 31, 2019	527,781
STAFF-8	Update certain tax items from the Company's estimated to actuals	(513,605)
TOTAL ADJUSTMENTS TO RATE BASE		(6,396,438)
COMMISSION ADOPTED RATE BASE		242,313,526

ATMOS ENERGY
COMMISSION ORDER
SUMMARY OF ADJUSTMENTS TO OPERATING INCOME
FOR THE TEST YEAR ENDED MARCH 31, 2019

	DESCRIPTION	AMOUNT
OPERATING INCOME PER APPLICANT		12,798,524
	ADJUSTMENTS TO OPERATING INCOME ACCEPTED BY THE COMMISSION	
STAFF-1	Payroll expense for 12 months ending August 31, 2019	(75,433)
STAFF-2	Payroll tax update (See Adj. No. 1)	49,345
STAFF-3	Benefit expense for 12 months ending August 31, 2019	202,065
STAFF-4	Equity Compensation Expense	559,029
STAFF-5	Depreciation Expense--Staff Depreciation Rates	2,413,239
STAFF-6	Bad Debt Expense	26,358
STAFF-7	Interest on Customer Deposits	1,102
STAFF-8	Advertising	9,605
STAFF-9	Donations	74,772
STAFF-10	Kansas Corporation Commission Assessment fees	8,070
STAFF-11	Miscellanous expenses	46,123
STAFF-12	Rate Case Expense	(323,667)
STAFF-13	Pension Expense Update through August 31, 2019	65,132
STAFF-14	OPEB Update through August 31, 2019	68,917
STAFF-15	Pension and Post Retirement tracker balances	(98,094)
STAFF-16	Lease Expense	(76,517)
STAFF-17	Weather Normalization	(466,047)
STAFF-18	Customer Annualization	119,039
STAFF-19	Income Tax Expense	(620,588)
TOTAL ADJUSTMENTS TO OPERATING INCOME		1,982,449
OPERATING INCOME ADOPTED BY THE COMMISSION		14,780,973

ATMOS ENERGY
COMMISSION ORDER
REVENUE REQUIREMENT CALCULATION
FOR THE TEST YEAR ENDED MARCH 31, 2019

LINE NO.	DESCRIPTION	AMOUNT
1	RATE BASE AS ADOPTED	242,313,526
2	RATE OF RETURN ON RATE BASE AS ADOPTED (1)	7.03%
3	NET OPERATING INCOME REQUIRED	17,034,641
4	PROFORMA OPERATING INCOME	14,780,973
5	DIFFERENCE	2,253,668
6	INCOME TAX FACTOR	0.734700
7	PROFORMA REVENUE INCREASE / (DECREASE)	3,067,466

(1) COMMISSION APPROVED CAPITAL STRUCTURE:

DESCRIPTION	CAPITALIZATION RATIO	COST OF CAPITAL	WEIGHTED COST OF CAPITAL
LONG TERM DEBT	43.68%	4.37%	1.91%
EQUITY	56.32%	9.10%	5.12%
TOTALS	100.00%		7.03%

CERTIFICATE OF SERVICE

19-ATMG-525-RTS

I, the undersigned, certify that a true copy of the attached Order has been served to the following by means of electronic service on 02/24/2020.

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CERTIFICATE OF SERVICE

19-ATMG-525-RTS

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