**BEFORE THE TENNESSEE REGULATORY AUTHORITY**

**NASHVILLE, TENNESSEE**

**January 8, 2015**

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| **IN RE:** | ) | |
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| **PETITION OF ATMOS ENERGY CORPORATION TO REVISE PERFORMANCE BASED RATEMAKING MECHANISM RIDER IN TARIFF** | ) ) ) | **DOCKET NO. 13-00111** |

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## ORDER APPROVING, IN PART AND DENYING, IN PART PETITION

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This matter came before Director Kenneth C. Hill, Director Robin Bennett, and Director David F. Jones of the Tennessee Regulatory Authority ("Authority" or "TRA"), the voting panel assigned to this docket, at the regularly scheduled Authority Conference held on June 16, 2014 for consideration of the *Petition to Revise Performance Based Ratemaking Mechanism Rider in Atmos Energy Corporation's Tariff* ("*Petition*") filed by Atmos Energy Corporation ("Atmos" or the "Company") on August 13, 2013.

### BACKGROUND

In its *Petition,* Atmos seeks to amend its Performance Based Ratemaking Mechanism Rider ("PBRM") Tariff. The Authority convened a contested case proceeding and appointed a Hearing Officer at the Authority Conference held on September 9, 2013.[1] The Consumer Advocate and Protection Division of the Office of the Attorney General ("Consumer Advocate" or "CAPD") filed a petition to intervene which was granted by the Hearing Officer in an order issued September 18, 2013.[2]

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[1] *See Order Convening a Contested Case and Appointing a Hearing Officer* (September 18, 2013).

[2] *See Order Granting Consumer Advocate's Petition to Intervene & Establishing Procedural Schedule* (September 18, 2013).

On November 13, 2013, TRA Party Staff ("Party Staff") filed a *Motion to Intervene*, which was granted during a Pre-Hearing Conference held on November 20, 2013.[3]

## HISTORY OF THE PBRM

The PBRM Rules became effective in 1993 and were designed to replace prudency reviews of gas companies having operating revenues in excess of two million five hundred thousand dollars ($2,500,000). Specifically, the rule encourages each gas company to minimize commodity cost by allowing it to share in any savings from this minimization.

The Atmos PBRM became permanent in 1999 and consists of two parts: (1) the Gas Procurement Incentive Mechanism and (2) the Capacity Management Incentive Mechanism. Under the Gas Procurement Incentive Mechanism, Atmos retains 50% of the savings on gas purchased below the lower end of the deadband (the range within which no savings or losses are calculated). The lower end, initially set at 97.7% of a pre-determined index, is re-set every three (3) years at 1% below the most recent annual audited results. Should the Company purchase gas above 102% of the same pre-determined index, the Company is penalized for 50% of the excess. The Capacity Management Incentive Mechanism encourages the Company to market off-peak unutilized transportation and storage capacity. The associated savings are shared by the ratepayers and the Company on a 90/10 basis. Total annual savings accruing to Atmos is capped at $1.25 million.

## *PETITION*

In its *Petition*, Atmos seeks to "remove a provision requiring readjustment of the deadband at the end of each three-year period to 1% below the most recent annual audited results

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[3] *See Order Granting TRA Party Staff Motion to Intervene & Establishing Procedural Schedule* (December 5, 2013).

of the incentive plan."[4] Atmos states that the way its deadband currently works is not a benefit to Atmos or the consumer.[5] Atmos proposes to delete the deadband reset provisions, and instead, use a "deadband of 97.7% to 102% of the total benchmark amounts for the GPIM ("Gas Procurement Incentive Mechanism") portion of the PBRM, with no provision for triennial readjustment."[6]

In its *Petition*, Atmos also proposes the following "housekeeping" changes to its tariff:

1. Deleting the Natural Gas Intelligence ("NGI") index from the gas cost benchmark indices. This request is made because this index is not used in any of the Company's eight states, it provides no significant useful information to the other indices and Atmos incurs a cost to annually subscribe to this index.[7]
2. Remove an outdated reference to the NORA supply contract of 1993 from the PBRM tariff. Since its inclusion in the tariff the contract has been renegotiated and is now included in the PBRM calculation of cost savings. Therefore, the reference is unnecessary.[8]
3. Amend the notice requirements in the Request for Proposal ("RFP") procedures contained in the PBRM tariff from advertising for a minimum of thirty days to advertising twice in a thirty day period.[9]
4. Amend the Reserve Margin language contained in the PBRM tariff to reflect the current practices of the Company. Specifically, remove the reference to propane and liquefied natural gas storage facilities since they no longer exist and change the language used to determine the coldest day.[10]

**<u>HEARING</u>**

A hearing in this matter was held before the voting panel on April 14, 2014, as noticed by the Authority on March 26, 2014. Participating in the hearing were the following parties and their respective counsel:

<u>Atmos Energy Corporation</u> - C. Scott Ross, Esq., Neal and Harwell, PLC, 150 Fourth Avenue North, Suite 2000, Nashville, TN 37219.

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[4] *Petition*, p. 1 (August 13, 2013).
[5] *Id.* at 3-4.
[6] *Id.* at 4.
[7] *Id.*
[8] *Id.*
[9] *Id.* at 4-5.
[10] *Id.* at 5.

Consumer Advocate – Joe Shirley, Esq., Office of the Attorney General, 425 Fifth Avenue North, Fourth Floor, John Sevier Building, P.O. Box 20207, Nashville, TN 37202.

TRA Party Staff – Shiva Bozarth, Esq., Tennessee Regulatory Authority, 502 Deaderick Street, Nashville, TN 37243.

Rebecca Buchanan appeared as a witness for Atmos, and Pat Murphy appeared as the witness for TRA Party Staff. The Consumer Advocate presented Dr. Christopher Klein as its witness. The witnesses were subject to cross-examination by the other parties and to questions from the panel. In addition, at the start of the Hearing, members of the public were given an opportunity to present comments to the panel. Following the Hearing, the parties presented closing arguments, and the panel took the matter under advisement.

**POSITIONS OF THE PARTIES**

***ATMOS***

The Company is requesting that the last sentence in the Commodity Cost section of the PBRM tariff be deleted.[11] This sentence reads: "At the end of each three-year period, the deadband will be readjusted to 1% below the most recent annual audited results of the incentive plan."[12] According to Atmos, once the Authority approves this deletion, Atmos will use a deadband range of 97.7% to 102% on a going forward basis.[13]

Atmos' current tariff provisions do not allow it to share in any gas procurement cost savings unless such savings result in the commodity cost being below the lower deadband amount. Atmos agrees that sharing commodity savings and costs is an incentive for the Company to prudently manage its commodity cost. However, Atmos asserts that the three-year re-set adjustment could result in the parameter of the deadband being set so low that the Company would not realize any shared savings, which provides no incentive for the Company to

[11] *Id.* at 3.
[12] Atmos Energy Corporation TRA tariff No. 1, 1st Revised Sheet No. 45.2.
[13] Rebecca M. Buchanan, Pre-filed Direct Testimony, p. 6 (August 13, 2013).

reduce its commodity cost. Atmos' witness, Ms. Buchanan, testified that the three-year adjustment to 1% below the most recent annual audited (actual) results does not fulfill the overall objective of the PBRM tariff. The Company asserts that since 2001, it has saved consumers over $19 million in commodity costs as compared to the bench mark.[14] Ratepayers received 100% of the first $12 million of this savings with Atmos receiving less than $3 million.[15] Ms. Buchanan states that forcing the Company to reset the deadband to a lower threshold provides no incentive for the Company to focus its efforts on reducing commodity cost in Tennessee. Ms. Buchanan maintains that while the Company would "not intentionally cause gas costs to increase" it would focus its resources on jurisdictional areas where the Company could share in any potential commodity cost savings, which may result in higher costs in Tennessee which would increase the deadband at the next three-year review.[16] With the deadband increased, Ms. Buchanan asserts that the Company would again have an incentive and hopefully procure gas well below the deadband thus reducing the deadband at the next three-year review. According to Ms. Buchanan, this results in an up-and-down effect on commodity cost and the deadband which should not occur under the PBRM.[17]

According to Ms. Buchanan, Atmos settled TRA Docket No. 07-00225 with the Consumer Advocate agreeing to an independent review of the transaction activities related to Asset Management.[18] There is nothing in the Settlement referring to the deadband as an issue or precluding the Authority from ruling on eliminating the three year adjustment of the deadband.[19] Reductions in the lower deadband have remained relatively small until the 2011/2012 PBR year.

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[14] *Id.* at 6.
[15] *Id.*
[16] *Id.* at 5.
[17] *Id.* at 4-6.
[18] *See In re: Docket to Evaluate Atmos Energy Corporation's Gas Purchases and Related Sharing Incentives,* Docket No. 07-00225, *Stipulation and Settlement Agreement*, p. 3 (May 7, 2013).
[19] Rebecca M. Buchanan, Rebuttal Testimony, pp. 2-3 (January 31, 2014).

A three-year gas supply and Asset Management Contract provided for new city gate delivered services saving the Company and ratepayers millions of dollars in avoided pipeline charges. Atmos maintains that for the first time in more than ten years since the inception of the PBRM, Atmos realized the approved shared savings cap of $1.25 million.[20]

Atmos explains that the commodity cost savings are coming to fruition because the resources of the Company are being directed toward strategies that result in avoided costs and discounted costs.[21] Currently, Atmos is the only utility achieving significant demand savings through city gate delivered services due to the fact that only Atmos' tariff specifically provides incentive for avoided cost via city gate delivered services.[22]

According to Atmos, Ms. Murphy's assertion that Atmos will receive an additional $1.25 million annually in future years if the deadband is maintained at 97.4% is inaccurate.[23] Atmos asserts that there is an annual cap of $1.25 million; therefore, Atmos will not receive an additional amount. Further, Atmos maintains that because current prices are based upon contracts that will expire in one to two years, there is no guarantee that the cost savings will continue in perpetuity.[24]

In response to Dr. Klein's testimony, Ms. Buchanan states "Atmos' current circumstances resulting in reduced or avoided cost are, in fact, due to unique circumstances that cannot be guaranteed to recur year after year."[25] Ms. Buchanan went on to state that this scenario is exactly what Dr. Klein referred to when he stated a resetting of the deadband would remove any incentives for the Company to seek reduced commodity cost.[26]

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[20] *Id.* at 8.
[21] *Id.* at 6.
[22] *Id.* at 7-8.
[23] *Id.* at 8-9.
[24] *Id.* at 9.
[25] *Id.* at 11.
[26] *Id.*

Ms. Buchanan explains that commodity cost savings within the deadband are not shared with Atmos.[27] It is only when the cost of gas savings falls below the deadband that Atmos is allowed to share on a 50/50 basis in those gas cost savings.[28] Over the last fourteen years Atmos has exceeded $26 million savings in commodity cost.[29] According to Ms. Buchanan, this was not an automatic savings, rather achieved through meticulous planning by Atmos employees assigned to procuring gas for Tennessee customers.[30]

Ms. Buchanan asserts that if the consultant is given the responsibility to review the tariff then there should be specific guidance on what is to be reviewed. [31] Additionally, Atmos will be "very much harmed and disincentivized by the reset of the deadband in the current year and for the next three years" while waiting on a consultant's report and recommendation on the tariff.[32] Ms. Buchanan acknowledges that any party may request that the triennial review process include a review of the incentive plan and the tariff, but Ms. Buchanan emphasizes that this review is not scheduled to start until next year and while this review is taking place, the deadband is being reset to this extremely low level.[33]

In closing, Ms. Buchanan clarifies that Atmos is not requesting the deadband be removed. They are only requesting that the deadband be based upon market indices and not the past performance of Atmos. Specifically, Atmos requests that the low end of the deadband be set at 97.7%.[34]

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[27] Transcript of Proceedings, p. 21 (April 14, 2014).
[28] *Id.* at 20.
[29] *Id.* at 19.
[30] *Id.* at 22-23.
[31] *Id.* at 36-37.
[32] *Id.* at 37.
[33] *Id.* at 41.
[34] *Id.* at 57.

***CONSUMER ADVOCATE***

The Consumer Advocate recommends suspending the removal of the deadband adjustment until 2017.[35] CAPD witness, Dr. Chris Klein, asserts this will give the Authority more time to evaluate the PBRM and allow more time to evaluate Atmos' asset management program pursuant to the TRA Docket 07-00225.[36] As Dr. Klein explains, the original low end of the deadband in the PBRM was set at 97.7% and the current low end is 97.4%.[37]

The Consumer Advocate states commodity costs have been 91.1% and 90.9% of the benchmark in the last two years.[38] Because of this decline, the low end of the deadband will reset to 1% below the gas cost performance to 89.9% in 2014.[39] Dr. Klein asserts this is the basis for the Company's assertion that the deadband will be too low to beat. According to Dr. Klein, this may or may not be true.[40] It depends on the reason that Atmos has been able procure gas below the benchmark for the last three years.[41] If Atmos has a new procurement strategy resulting in a permanent reduction in the commodity cost below the deadband, then resetting the deadband will still provide an incentive for Atmos to reduce its commodity cost.[42] If, however, the reduced commodity cost for the last three years is due to incidents not expected to recur and beyond the control of Atmos, then resetting the deadband may result in eliminating the incentive for Atmos to reduce its commodity cost.[43]

Dr. Klein argues that maintaining 97.4% as the low end of the deadband for the next three years preserves the incentive to Atmos for commodity cost savings, and the incentive for future

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[35] Dr. Christopher C. Klein, Pre-filed Direct Testimony, p. 8 (November 20, 2013).
[36] *Id.* at 8-9.
[37] *Id.* at 6.
[38] *Id.* at 7.
[39] *Id.*
[40] *Id.*
[41] *Id.*
[42] *Id.*
[43] *Id.* at 7-8.

savings is not eliminated forever.[44] If, however, the deadband is reset and the commodity cost has been permanently reduced, there is no future incentive for Atmos to reduce cost.[45] Further, if the commodity cost reduction is permanent, then Atmos will receive its share of the savings ($1.25 million annually) for the next three years with no effort on its part to reduce commodity cost.[46]

The Consumer Advocate attests that the settlement agreement in TRA Docket No. 07-00225 requires the asset management activities of Atmos to be reviewed by an independent consultant in the fall of 2014, with a report of its findings by July 1, 2015.[47] Since asset management activities drive commodity cost under the PBRM, suspending the removal of the deadband adjustment would allow the Authority ample time to review the report and determine the possible reasons for the cost savings and the need of resetting the deadband.[48]

The Consumer Advocate offers testimony on one of the four other changes to the PBRM tariff. The CAPD does not object to removing the NGI index from the commodity savings calculations. Dr. Klein asserts that removal of this index has little effect on the end result, and because this index is usually between the Inside FERC and NYMEX indexes it provides little information to the calculation.[49]

Dr. Klein testified that if one accepts that the Company's performance is the new normal, then Party Staff's recommendation is appropriate.[50] This would re-set the deadband to 89.9% and continue to provide an incentive for the Company to out-perform its previous actions. On the contrary, if one accepts that the Company's performance for the 2011-2013 time period is

[44] *Id.* at 8.
[45] *Id.* at 9.
[46] *Id.*
[47] *Id.* at 9-10.
[48] *Id.* at 9.
[49] *Id.* at 9-10.
[50] Transcript of Proceedings, p. 84 (April 14, 2014).

unusual and may have reached the maximum savings one could expect, then Atmos' recommendation is appropriate.[51]

Dr. Klein recommended maintaining the status quo for three years, which would continue the deadband at 97.4% and continue to provide an incentive for the Company to out-perform its pervious actions of the current deadband.[52] In addition, Dr. Klein states that this method would give the Authority an additional three years of information to determine what is normal and to allow for the completion of the independent review of the asset management program.[53]

***<u>PARTY STAFF</u>***

During the hearing, Party Staff explained that it is not opposed to the concept of a change to the incentive plan, stating "[w]e actually take no position on the possibility of changes to the incentive plan."[54] Party Staff states that "it is Party Staff's position that the incentive program should be included in the triennial review and analyzed in the triennial review process, and as a totality after analysis, then the Authority could review both the outside, independent reviewer's, as well as, the staff, Consumer Advocate's, and Atmos' position on these changes and come to an appropriate decision for all parties involved."[55] Party Staff's witness, Pat Murphy states that Party Staff's only concern is that "removing a significant provision of the incentive plan is premature without a complete review of the possible effects of such changes on the balance of the tariff incentives as a whole."[56]

In her affidavit filed on November 25, 2014, Ms. Murphy outlines the background of the PBRM and asset management and their correlation with each other in past proceedings.[57] She

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[51] *Id.* at 84-85.
[52] *Id.*
[53] *Id.*
[54] *Id.* at 14.
[55] *Id.* at 15.
[56] *Id.* at 64.
[57] Affidavit of Pat Murphy, p. 3 (November 25, 2013).

attests to having personal knowledge in the proceedings to establish the PBRM and the auditing of the PBRM since that time.[58] According to Ms. Murphy, while the asset management issue was pending before the Authority, Atmos was granted approval to include the sharing of asset management fees under its PBRM in TRA Docket No. 11-00195.[59]

Ms. Murphy outlines the dockets opened by this Authority to address asset management issues with specific reference to TRA Docket No. 07-00225. According to Ms. Murphy, the issues in that docket specifically addressed the compensation for the release of capacity assets and the sharing of the lump sum fee received from the asset manager, which flows through the PBRM.[60] For this reason, Ms. Murphy states it is logical that any asset management review would also encompass a review of the PBRM.[61] Ms. Murphy also supports this view by referencing the language of the approved Settlement Agreement in that docket.[62] According to Ms. Murphy, she believes "the terms 'transactions and activities related to Asset Management' as contained in paragraph 7 of the Settlement Agreement would necessarily involve reviewing these activities in the context of the PBRM tariff, since the review procedures are part of the PBRM tariff....Virtually all savings reported under Atmos' PBRM to date resulted from its Asset Management and Gas Supply Contract with its affiliated Asset manager, Atmos Energy Marketing."[63]

Party Staff maintains that the categories in the asset management review, as outlined in the Settlement Agreement, are identical to that of the Piedmont Natural Gas and Chattanooga

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[58] *Id.*
[59] *Id.* at 4; *See In re: Audit of Atmos Energy Corporation's Incentive Plan Account for the Period April 1, 2004 through March 31, 2007*, Docket No. 11-00195, *Order* (September 10, 2012).
[60] *Id.* at 4-5.
[61] *Id.*
[62] *Id.* at 5- 6.
[63] *Id.* at 6.

Gas Review procedures.[64] Ms. Murphy asserts that changing the language in Piedmont's and Chattanooga's plan from "transactions and activities" of their respective incentive plans to "transactions and activities related to Asset Management" in the Atmos plan does not necessarily limit the scope to exclude the PBRM tariff because flow through of Asset Management savings is included in the PBRM tariff.[65]

Regarding the CAPD's recommendation, Ms. Murphy opines that if Dr. Klein's recommendation to maintain a deadband level of 97.4% for three years is adopted, it may result in Atmos receiving an additional $1.25 million annually in future years with little or no effort on its part to produce any commodity cost savings.[66] This scenario could occur because the lower cap of 89.9%, which was established in Docket No. 13-00084, demonstrates that Atmos is purchasing below the 97.4% level; therefore, if Atmos were to continue to purchase at the 89.9% level and the deadband is set at 97.4%, Atmos could possibly receive savings, up to the $1.25 million cap, with little or no effort on its part to cut commodity costs.[67]

Ms. Murphy maintains that "the filing of a revised PBRM tariff by Atmos seeking to alter, change or remove certain provisions of its Incentive Plan without a complete review of the possible effect of such changes on the tariff incentives as a whole is premature… ."[68] Therefore, Party Staff recommends this docket be closed without prejudice and the deadband remain at 89.9%, the levels approved in TRA Docket No. 13-00084.[69]

During the hearing, Ms. Murphy requested that if, as a compromise to the positions of Atmos and the Consumer Advocate, the Authority decides to postpone resetting the lower end of

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[64] *Id.* at 7.
[65] *Id.*
[66] *Id.* at 8.
[67] *Id.* at 7-8; *See In re: Audit of Atmos Energy Corporation's Incentive Plan Account for the Period of April 1, 2012 through March 31, 2013*, Docket No. 13-00084, *Order Adopting Incentive Plan Audit Report of TRA's Utilities Division* (September 23, 2013).
[68] *Id.* at 10.
[69] *Id.* at 11.

the deadband pending the conclusion of the independent review, the deadband be reset to an average of the last three years, which would be 93.4%.[70]

## FINDINGS AND CONCLUSIONS

At the regularly scheduled Authority Conference held on June 16, 2014, the panel considered Atmos' *Petition*. The panel found that any consideration of eliminating the re-setting of the deadband must include a comprehensive review of the entire incentive plan. Each portion of the incentive plan takes into consideration other areas or portions. For example, sharing percentages may need to be adjusted if the deadband remains the same, is eliminated or is modified. The panel also agreed with CAPD witness, Dr. Klein, that Atmos has not provided sufficient evidence in this case to support completely eliminating a re-setting of the deadband, much less the effect such elimination would have on consumers.

The panel found that Dr. Klein presented the most reasonable approach regarding setting the lower end of the deadband, which was to wait three years and see if cost savings realized from 2011 through 2013 represented a normal level or was an unusual result. The consultant's review required by Docket No. 07-00225 should provide additional information and insight as to what deadband range is appropriate and whether the range should ever be reset.

Upon consideration of the record and arguments of counsel, the panel voted unanimously that Atmos' *Petition* be approved, in part, and denied, in part, as follows:

First, concerning the deadband, that the lower end of the deadband be set to 97.4% for the next three years. The panel found that this approach is reasonable and should provide an incentive for future cost savings for Consumers and the Company. Atmos' request to eliminate the three year re-setting of the deadband is denied.

[70] Transcript of Proceedings, pp. 66-67 (April 14, 2014).

Next, since the changes are primarily housekeeping, approve the other tariff provisions proposed in the petition as follows:

- Delete the NGI index from the gas cost benchmark indices;
- Remove an outdated reference to the NORA supply contract of 1993 from the PBRM tariff;
- Amend the notice requirements in the RFP procedures contained in the PBRM tariff from advertising for a minimum of thirty days to advertising twice in a thirty day period;
- Amend the Reserve Margin language contained in the PBRM tariff to reflect the current practices of the Company; and
- Change the language used to determine the coldest day to reference the coldest day since 1970 instead of the coldest day in the last five years."

Lastly, the scope of the triennial review set to conclude in July 2015 should include a review of the deadband range, including an evaluation of an appropriate deadband range and whether one is necessary. This will ensure that the Authority is provided additional expert information on this topic prior to a decision regarding the re-setting of the deadband as proposed by Atmos.

**IT IS THEREFORE ORDERED THAT:**

1. Atmos Energy Corporation's *Petition to Revise Performance Based Ratemaking Mechanism Rider in Atmos Energy Corporation's Tariff* is granted, in part, and denied, in part.

2. The lower end of the deadband shall be set at 97.4% for the next three years, or until March 2017.

3. Atmos' request to eliminate the three-year resetting of the deadband is denied.

4. The proposed clean up provisions as outlined in Atmos Energy Corporation's *Petition to Revise Performance Based Ratemaking Mechanism Rider in Atmos Energy Corporation's Tariff* are approved.

5. The scope of the triennial review set to conclude in July 2015 shall include a review of the deadband range, including an evaluation of an appropriate deadband range and whether one is necessary.

**Director Kenneth C. Hill, Director Robin Bennett, and Director David F. Jones concur.**

**ATTEST:**

Earl Taylor abh

**Earl R. Taylor, Executive Director**