

1 I am responsible for managing rate proceedings filed primarily with state
2 regulatory bodies on behalf of the Company. My responsibilities include
3 execution of applications for changes to rates and tariffs as part of traditional rate
4 cases, tariff language change proposals, and annual rate making mechanisms that
5 the Company files in the 8 states in which it has regulated operations.

6 **Q. HAVE YOU TESTIFIED BEFORE THIS OR ANY OTHER**
7 **REGULATORY COMMISSION?**

8 A. Yes. I testified before the Tennessee Regulatory Authority ("Authority") in
9 Docket No. 05-000258 I also submitted testimony in Docket Nos. 07-00105, 08-
10 00197, 12-00064 and 14-00081. I testified before the Kentucky Public Service
11 Commission in 2014 and the Georgia Public Service Commission in 2008, 2009
12 and 2011. And I submitted direct testimony in the Company's rate proceedings in
13 Kentucky (2006, 2009 and 2013) and Virginia (2008, 2013 and 2014).

14
15 **II. PURPOSE OF TESTIMONY**

16 **Q. WHAT SUBJECT AREAS DO YOU INTEND TO COVER IN YOUR**
17 **TESTIMONY?**

18 A. I will testify concerning the following subject areas:

- 19 1. Calculation of the Company's projected revenue deficiency for the
20 attrition year that ends May 31, 2016. The total projected revenue
21 deficiency for that year is approximately \$5.89 million, as shown in the
22 attached Revenue Requirement Model, Schedules 1-10 of which are
23 attached as Exhibit GKW-1.

- 1 2. Forecast of operating expenses and calculation of average rate base for
2 that same period. The projected attrition year rate base is approximately
3 \$254.7 million as shown in Schedule 7 of Exhibit GKW-1.
- 4 3. The Company's operating expense and capital budget processes.
- 5 4. Control and monitoring of O&M and Capital Expenditure ("Capex")
6 budget variances.
- 7 5. The mechanics of the Company's proposed annual rate review mechanism
8 in support of the proposed tariff, which is attached to my testimony as
9 Exhibit GKW-2. As the second part of this two part case, the Company
10 seeks approval to opt into an annual review of its rates pursuant to
11 Tennessee Code Annotated Section 65-5-103(d)(6).

12 **Q. DO YOU HAVE ANY EXHIBITS ATTACHED TO YOUR TESTIMONY?**

13 A. Yes. I have two Exhibits.

- 14 • Exhibit GKW-1: Schedules 1-10 and supporting workpapers of the
15 Revenue Requirement Model. Schedule 11 of the Revenue
16 Requirement Model is attached as Exhibit PJC-1 to the testimony of
17 Company witness Patricia Childers.
- 18 • Exhibit GKW-2: The proposed Annual Review Mechanism (ARM)
19 tariff

20 **Q. WHAT CALCULATIONS HAVE YOU PERFORMED FOR YOUR**
21 **TESTIMONY IN THIS PROCEEDING?**

22 A. I have calculated the Company's projected revenue deficiency for the attrition
23 year ended May 31, 2016. I also have calculated operating expenses and average

1 rate base for the period. My calculations incorporate the capital structure and rate
2 of return presented by Mr. Joe Christian, the rate of return on equity presented by
3 Dr. James Vander Weide, and the revenue at present rates presented by Ms.
4 Patricia Childers. The deficiency and supporting calculations are shown in the
5 Revenue Requirement Model, Schedules 1-10 of which are attached as Exhibit
6 GKW-1. Schedule 11 of the Revenue Requirement Model is attached as Exhibit
7 PJC-1 to the testimony of Patricia Childers. The lead-lag analysis used to
8 calculate the Company's cash working capital requirement to be included in rate
9 base is sponsored by Mr. Joe Christian.

10
11 **III. REVENUE REQUIREMENT MODEL SCHEDULES**

12 **Q. PLEASE LIST THE SCHEDULES THAT COMPRISE EXHIBITS GKW-1**
13 **AND PJC-1, THE COMPANY'S REVENUE REQUIREMENT MODEL.**

14 A. Schedules 1-11 are listed below. These are the same 11 Schedules listed and
15 described in the proposed ARM tariff, which is attached as Exhibit GKW-2. The list
16 of Schedules is as follows:

17 Schedule 1: Cost of Service

18 Schedule 2: Summary of Revenues at Present Rates

19 Schedule 3: Cost of Gas

20 Schedule 4: Operation and Maintenance Expenses

21 Schedule 5: Taxes Other than Income

22 Schedule 6: Depreciation and Amortization Expenses

23 Schedule 7: Rate Base and Return

24 Schedule 8: Computation of State Excise and Income Taxes

1 Schedule 9: Overall Cost of Capital
2 Schedule 10: Rate of Return
3 Schedule 11: Proof of Revenues and Calculation of Rates

4 **Q. PLEASE EXPLAIN SCHEDULE 1.**

5 A. Schedule 1 summarizes the elements of the cost of service, including gas cost
6 expense, operation and maintenance expense, depreciation expense, taxes other
7 than income taxes, return on rate base, income tax, allowance for funds used
8 during construction ("AFUDC") and interest on customer deposits. Schedule 1
9 compares the total cost of service to revenues at present rates in order to calculate
10 a net revenue deficiency or sufficiency. Schedule 1 sources data from each of the
11 other schedules.

12 **Q. PLEASE EXPLAIN SCHEDULES 2 AND 3.**

13 A. Schedule 2 shows per book revenues for the Historic Base Period ended June 30,
14 2014 and the projected Forward Looking Test Year revenues from Schedule 11.
15 Schedule 3 shows the Historic Base Period per books gas cost and the projected
16 cost of gas. The Forward Looking Test Year cost of gas is adjusted to remove
17 rent for inter-company leased storage property that is booked to gas cost. This
18 adjustment is consistent with the Authority's requirement in all of the Company's
19 rate filings since 1989.

20 **Q. PLEASE EXPLAIN SCHEDULE 4.**

21 A. Schedule 4 shows the Historic Base Period per books operation and maintenance
22 expense, and the projected Forward Looking Test Year operation and
23 maintenance expense. The Schedule includes an adjustment to the Forward

1 Looking Test Year operation and maintenance expense to remove rent on inter-
2 company leased property and include operating expenses for that property. This
3 adjustment is consistent with the Authority's requirement in all of the Company's
4 rate filings since 1989.

5 **Q. PLEASE PROVIDE MORE DETAIL ON THE DEVELOPMENT OF THE**
6 **FORWARD LOOKING TEST YEAR OPERATIONS AND**
7 **MAINTENANCE EXPENSE.**

8 A. The basis for the projected Forward Looking Test Year Operations and
9 Maintenance ("O&M") expense is the Company's fiscal year 2015 ("FY2015")
10 budget. Consistent with our normal annual budgeting timelines, this budget was
11 prepared during the summer of 2014. This budget was prepared in the manner I
12 describe later in my testimony. For the months of June through September 2015
13 (the first four months of the Forward Looking Test Year), the Forward Looking
14 Test Year O&M is the Company's recently-completed FY2015 budget with no
15 inflation adjustment required. For the months of October 2015 – May 2016 (the
16 last eight months of the Forward Looking Test Year), I used the FY2015 budget
17 for October 2014– May 2015 and adjusted for inflation as I will describe in detail
18 below. The Forward Looking Test Year projection was converted into FERC
19 account detail using the method described later in my testimony.

20 **Q. WHAT ARE THE COMPONENTS OF O&M FOR THE FORWARD**
21 **LOOKING TEST YEAR?**

22 A. The Forward Looking Test Year O&M is comprised of three parts: expenses
23 incurred and booked directly in Tennessee, allocated expenses from the

1 Kentucky/Mid-States Division's General Office, and allocated expenses from the
2 Company's Shared Services Unit ("SSU"). These components are itemized on
3 WP 4-1.

4 **Q. WITHIN THAT CONTEXT, PLEASE DESCRIBE THE DEVELOPMENT**
5 **OF EACH O&M EXPENDITURE TYPE, BEGINNING WITH LABOR.**

6 A. Labor expense for the first four months of the Forward Looking Test Year is the
7 Company's fiscal year 2015 labor budget, unadjusted, for those months for
8 Tennessee operations and the entities that allocate costs to Tennessee. The last
9 eight months of the Forward Looking Test Year are adjusted to account for the
10 Company's annual merit increase. Base pay increases go into effect each October
11 1 and have averaged 3.0% annually for the past several years. An adjustment was
12 made as part of the forecast to account for an average wage increase of 3.0% to
13 become effective October 1, 2015.

14 **Q. PLEASE EXPLAIN YOUR FORECAST FOR AND ADJUSTMENTS TO**
15 **BENEFITS.**

16 A. Benefits are budgeted as a fixed benefit load percentage of labor expense. An
17 adjustment to the fixed benefit load percentage was made in order to comply with
18 long standing Tennessee rate making precedent and to propose the continuation of
19 the treatment of pension expense that was prescribed in the Final Order in Docket
20 No 12-00064. Long standing Tennessee precedent allows utilities recovery of
21 actual cash contributions made to pension funds rather than the FAS 87 expense
22 charged to O&M as required by generally accepted accounting principles
23 (GAAP). In Docket No. 12-00064, the parties agreed to allow a "benchmark"

1 amount of FAS 87 recovery in revenue requirement while requiring the Company
2 to defer into a regulated asset or liability any amount above or below the
3 benchmark on a quarterly basis. By doing so, the parties minimized the
4 likelihood of large spikes in rates caused when the Company is required to make
5 large cash contributions to its pension fund to keep the fund at an appropriately
6 funded level. The benchmark was determined by a study conducted by Towers
7 Watson, the Company's actuary. The study determined the total future pension
8 liability of the Company, the amount of that liability related to current and prior
9 Tennessee employees (including and allocation of the liability related to
10 employees allocable to Tennessee) and used that data to determine the amount of
11 the Company's minimum required contribution (also determined by Towers
12 Watson) that is allocable to Tennessee. The process to determine the amount of
13 pension contribution appropriately allocable to Tennessee was originally
14 developed in Docket No. 08-00197.

15 The Company is proposing to continue this process in the current
16 proceeding and in its future annual rate reviews. The adjustment removes the
17 accrual for FAS 87 expenses in the calculation of the fixed benefits load. Because
18 the Company's most recent actuarial report from Towers Watson specifies a
19 minimum required contribution of zero for next fiscal year, nothing is added back
20 to O&M in this proceeding. The process to develop the appropriate allocation,
21 however, is detailed on WP 4-4. The Company proposes to use this process to
22 update the benchmark as part of each annual filing and defer any amount above or
23 below that amount quarterly into a regulatory asset or liability.

1 **Q. PLEASE EXPLAIN YOUR ADJUSTMENT RELATING TO RENT.**

2 A. Unlike other O&M categories that are likely to increase with normal inflation, our
3 building rents are driven by leases already in place and can therefore be projected
4 with a high level of accuracy. Thus, a zero percent inflation factor is applied to
5 rent expense.

6 **Q. PLEASE EXPLAIN YOUR ADJUSTMENT RELATING TO BAD DEBT.**

7 A. Our goal is to maintain bad debt no higher than 0.50% of residential, commercial,
8 and public authority gross margins during any given year. Ms. Patricia Childers
9 calculated 0.50% of residential, commercial and public authority gross margins
10 from her revenue projection detailed on Schedule 11.

11 **Q. PLEASE EXPLAIN YOUR ADJUSTMENT RELATING TO OTHER**
12 **O&M.**

13 A. O&M expense types other than labor, benefits, rent, and bad debt are forecasted
14 using a standard inflation factor to adjust the last eight months of the Forward
15 Looking Test Year. The 1.84% inflation factor used is the average inflation rate
16 for the southern region over the last two years as reported by the U.S. Department
17 of Labor. The development of the O&M forecast is consistent for each entity that
18 allocates costs to Tennessee. The appropriate level of expenses are allocated to
19 the Tennessee rate jurisdiction per the methodologies described in the Company's
20 Cost Allocation Manual attached the testimony of Company witness Jason
21 Schneider.

22 **Q. DID YOU MAKE ANY ADJUSTMENTS FOR THE AMORTIZATION OF**
23 **RATE CASE EXPENSE?**

1 A. Yes. While the balance of the deferred rate case expenses associated with Docket
2 No. 12-00064 has been fully amortized, I have estimated the cost of litigating this
3 proceeding to be \$525,000. I have made an adjustment to O&M to account for a
4 three year amortization of this estimated expense. Because the Company is
5 opting into an annual rate review following this proceeding, annual expenses
6 associated with prosecuting such annual filings are expected to be minimal and
7 annually recurring. Therefore, the Company does not plan to seek deferred
8 treatment for rate case expenses following the amortization of expenses relating to
9 this case (as long as the annual rate review remains in effect).

10 **Q. PLEASE EXPLAIN SCHEDULE 5.**

11 A. Schedule 5 shows Historic Base Period per books taxes other than income taxes
12 expense, and Forward Looking Test Year taxes other than income taxes expense.
13 Taxes, other than income taxes, like O&M, are comprised of three components:
14 direct Tennessee taxes, taxes allocated from the General Office, and taxes
15 allocated from SSU. These components are itemized by type of tax on WP5-1.
16 The amount of taxes allocated from the Division General Office and SSU is based
17 upon the cost allocation methodology more fully explained in the Company's
18 Cost Allocation Manual attached the testimony of Company witness Jason
19 Schneider. I have adjusted the Forward Looking Test Year taxes other than
20 income taxes expense to include taxes for intercompany leased property.

21 **Q. PLEASE EXPLAIN SCHEDULE 6.**

22 A. Schedule 6 shows the Historic Base Period per books depreciation and
23 amortization expense, and the Forward Looking Test Year depreciation and

1 amortization expense. Depreciation and amortization expense for the Forward
2 Looking Test Year is calculated, using depreciation rates most recently approved
3 in Tennessee, on WP 6-2. The depreciation rates for SSU and the division
4 General Office have been applied to the applicable categories of plant, resulting in
5 an allocation of depreciation expense to Tennessee based upon the cost allocation
6 methodology more fully explained in the Company's Cost Allocation Manual
7 attached to the testimony of Company witness Jason Schneider. I have adjusted
8 the Forward Looking Test Year depreciation expense to include expense for
9 intercompany leased property. This adjustment is consistent with the Authority's
10 requirement in all of the Company's rate filings since 1989. In addition, I have
11 adjusted amortization expense to account for a 2 year amortization of the
12 Company's regulatory asset related to pension expense that was created in
13 accordance with the Final Order in Docket No. 12-00064.

14 **Q. PLEASE PROVIDE MORE DETAIL ON THE SOURCE OF THE**
15 **DEPRECIATION RATES USED TO CALCULATE DEPRECIATION AND**
16 **AMORTIZATION EXPENSE ON SCHEDULE 6.**

17 A. The depreciation rates currently used for the Company's assets in its direct
18 Tennessee operations are based on a depreciation study using plant data through
19 fiscal year 2006 and were approved in Docket No. 07-00105. I will discuss the
20 Company's specific proposal for handling depreciation rates in future annual rate
21 review filings later in my testimony. The depreciation rates currently used for the
22 General Office of the Kentucky Mid-States operating division are based on a
23 depreciation study using data through fiscal year 2007 and were approved in

1 Docket No. 08-00197. The depreciation rates currently used for SSU assets are
2 based on a depreciation study using data through fiscal year 2010 and were
3 approved in Docket No. 12-00064. The rates contained in that study and
4 approved by the Authority are the same rates approved and booked by the
5 Company in 7 of the 8 states we serve, including Tennessee.

6 **Q. PLEASE EXPLAIN SCHEDULE 7.**

7 A. Schedule 7 shows the calculation of the Historic Base Period per books rate base,
8 and Forward Looking Test Year rate base. The rate base includes the projected
9 thirteen month averages of the original cost of plant, accumulated depreciation,
10 storage gas investment, materials and supplies, accumulated deferred income tax
11 (“ADIT”), customer advances, customer deposits and accumulated interest on
12 customer deposits. These items are generally consistent with the items included
13 in rate base in the company’s monthly 3.03 reports to the TRA.

14 **Q. WHAT ADJUSTMENTS ARE MADE TO THE HISTORICAL BASE**
15 **PERIOD AND FORWARD LOOKING TEST YEAR RATE BASE?**

16 A. In addition to the items included in the 3.03 reports, Schedule 7 includes
17 adjustments for cash working capital and the net book value of inter-company
18 leased property. This leased property adjustment is consistent with the
19 Authority’s requirement in all of the Company’s rate filings since 1989.

20 **Q. WHAT OTHER ADJUSTMENTS ARE MADE TO THE HISTORICAL**
21 **BASE PERIOD AND FORWARD LOOKING TEST YEAR RATE BASE?**

1 A. In addition, I have adjusted rate base to include the average balance of the
2 Company's regulatory asset related to pension expense deferral that was created
3 in accordance with the Final Order in Docket No. 12-00064.

4 **Q. HOW IS THE FORWARD LOOKING TEST YEAR RATE BASE**
5 **DEVELOPED?**

6 A. Each of the other rate base items is projected into the Forward Looking Test Year
7 individually. The projected plant amounts are based on projected capital
8 additions as discussed later in my testimony. The projected accumulated
9 depreciation incorporates the currently-approved depreciation rates as discussed
10 earlier in my testimony. CWIP is projected to remain at the June 2014 level
11 through the Forward Looking Test Year as capital spending is offset by
12 completing projects and placing assets in service. Forward Looking Test Year
13 storage gas balances are based on actual balances through June 2014, the last day
14 of the Historic Base Period, and forecasted storage usage with future injections
15 priced at NYMEX futures prices as of November 2014. Materials and supplies
16 and customer advances are predicted to remain at the June 2014 level, the last day
17 of the Historic Base Period, through the Forward Looking Test Year. Forward
18 Looking Test Year accumulated deferred income taxes were calculated by the
19 Company's tax department based on plant forecasts. Customer deposits are
20 projected to increase at 0.35% annually from test year levels.

1 **Q. HOW IS CASH WORKING CAPITAL CALCULATED IN THIS FILING**
2 **AND HOW DO YOU PROPOSE TO CALCULATE IT IN FUTURE**
3 **ANNUAL FILINGS?**

4 A. The Company conducted a lead-lag study in order to calculate cash working
5 capital requirements. The study is incorporated in the testimony of Company
6 witness Joe Christian. Rather than conduct a new lead-lag study with each annual
7 rate review filing, the Company will apply the lead-lag factors from this study to
8 the subsequent annual Forward Looking Test Year expenses and revenues in
9 order to calculate cash working capital requirements.

10 **Q. PLEASE ELABORATE ON FORECASTED PLANT ADDITIONS.**

11 A. Plant additions for the period between the end of the Historic Base Period and the
12 end of the Forward Looking Test Year are made up of projected and budgeted
13 plant additions from the Company's monthly projections and most recently
14 completed capital budget. The total capital budget is comprised of three
15 components: (1) the capital spending for Tennessee for the forecasted period; (2)
16 the amount allocated to Tennessee resulting from capital spending by the
17 KY/Mid-States Division's general office; and (3) the amount allocated to
18 Tennessee resulting from capital spending by the Company's Shared Services
19 (SSU) during the Forward Looking Test Year. Tennessee's capital budget was
20 developed by the following major categories:

- 21 1. Equipment;
- 22 2. Growth;
- 23 3. Information Technology (IT);

4. Pipeline Integrity;
5. Public Improvements;
6. Structures;
7. System Improvements;
8. System Integrity; and
9. Vehicles.

The capital budget is converted to plant account ("300 account") detail for the purpose of projecting additions, retirements, depreciation expense, accumulated depreciation and resulting net plant.

Q. PLEASE EXPLAIN THE PROPER RATEMAKING TREATMENT OF ADIT LIABILITIES AND NOLC ADIT ASSETS AS THEY ARE REFLECTED IN SCHEDULE 7 AND SUPPORTING WORKPAPERS.

A. The Company's rate base has been reduced by its net accumulated deferred income tax (ADIT) liability balance. Embedded within the ADIT liability balance is an asset for net operating loss carryforwards (NOLCs).

ADIT liabilities are realized because the Company's tax filings reflect tax deductions in excess of book deductions, for example, accelerated tax depreciation. These excess tax deductions offset the Company's current tax liability which allows the Company to retain cash that would have otherwise been paid to the government. The benefit of this excess cash is reflected as a reduction to the Company's required rate base until that time it is repaid to the government. These funds are repaid to the government over time as the Company's book

1 deductions exceed its tax deductions and are appropriately reflected as a reduction
2 to rate base until the funds are repaid to the government.

3 In certain situations, the Company's tax deductions can produce a tax net
4 operating loss. A tax net operating loss is realized when the Company's tax
5 deductions exceed its taxable income and all tax has been offset. These unused
6 tax deductions are reflected on the Company's tax returns as a net tax operating
7 loss which is available to be carried back or carried forward to offset taxable
8 income. The Company has fully utilized its ability to carryback tax net operating
9 losses and may only carryforward its remaining tax net operating losses. These
10 carryforwards have not yet offset tax and are reflected on the Company's books
11 and records as an ADIT asset for NOLCs. These NOLCs will be used in future
12 periods to offset tax. Just as ADIT liabilities represent cash received by the
13 Company, the NOLC represents funds the Company has not yet received from the
14 government.

15 To fully account for the net cash realized from the government in the form
16 of tax savings, all of the ADIT balances, both assets and liabilities, must be
17 included in the calculation of the ADIT rate base reduction. This calculation is
18 reflected on Schedule 7 and the supporting workpapers.

19 **Q. DID YOU MAKE ANY ADJUSTMENT TO BOOKED OR PROJECTED**
20 **ADIT AMOUNTS?**

21 A. Yes, a non-utility item on shared services books was adjusted out of ADIT. The
22 adjustment is shown on WP 7-4. The Company has separated the ADIT
23 associated with the consolidated tax net operating loss between the utility and

1 non-utility operations based on the utility operation's stand-alone contribution to
2 the creation of the losses through tax depreciation deductions. The utility related
3 ADIT associated with the consolidated tax net operating loss is included in the
4 rate base calculation and the non-utility related ADIT associated with
5 consolidated tax net operating loss is not included in the rate base deduction.

6 **Q. PLEASE EXPLAIN SCHEDULE 8.**

7 A. Schedule 8 shows the calculation of state excise taxes and income taxes on the
8 required return on rate base for both the Historic Base Period and the Forward
9 Looking Test Year.

10 **Q. PLEASE EXPLAIN SCHEDULE 9.**

11 A. Schedule 9 shows the calculation of the overall cost of capital based on the capital
12 structure, debt cost rates and the required rate of return on equity that are required
13 based on the testimony of Mr. Joe Christian and Dr. James Vander Weide.

14 **Q. PLEASE EXPLAIN SCHEDULE 10.**

15 A. Schedule 10 shows the calculation of a rate of return on rate base and a rate of
16 return on the equity financed portion of rate base for the Historic Base Period and
17 the Forward Looking Test Year, with costs and revenues as presented in
18 Schedules 2 through 9.

19 **Q. PLEASE EXPLAIN SCHEDULE 11.**

20 A. Schedule 11 presents the forecasted billing determinants and calculation of new
21 tariff rates by customer class and rate schedule for the Forward Looking Test
22 Year consistent with the cost of service and net revenue deficiency / sufficiency

1 presented in Schedule 1. It is attached as Exhibit PJC-1 to the testimony of
2 Company witness Patricia Childers.

3
4 **IV. ANNUAL RATE REVIEW MECHANISM**

5 **Q. COMPANY WITNESS PATRICIA CHILDERS INTRODUCED THE**
6 **COMPANY'S ANNUAL RATE REVIEW PROPOSAL THAT WILL BE**
7 **PART TWO OF THIS TWO PART CASE. CAN YOU PROVIDE**
8 **DETAILS?**

9 A. Yes. As part two of this two part case, the Company seeks to exercise its
10 statutory right to opt-in to an annual review of its rates pursuant to Tennessee
11 Code Annotated Section 65-5-103(d)(6). This proceeding will serve as the
12 qualifying rate case required by the statute. For each of its annual rate reviews, the
13 Company proposes to calculate and support its revenue requirement with the same
14 eleven schedules and supporting work papers ("Schedules") that document,
15 calculate, and support the Company's cost of service and resulting revenue
16 deficiency or sufficiency in this proceeding. The proposed Schedules are attached
17 to my testimony and the testimony of Ms. Patricia Childers as Exhibit GKW-1
18 (Schedules 1-10) and Exhibit PJC-1 (Schedule 11).

19 **Q. WHAT TIME FRAME IS THE COMPANY PROPOSING TO EMPLOY**
20 **FOR ITS ANNUAL RATE REVIEW FILINGS?**

21 A. The Company plans to make each annual filing, including Schedules 1-11 and
22 supporting work papers, on or before September 1st of each year. This is the
23 Annual Filing Date referenced in Exhibit GKW-2, the Company's proposed tariff.

1 The Historic Base Period will be the 12 months ending June 30th each year and
2 the Forward Looking Test Year will begin each January 1st following the
3 September 1st filing. This timeframe allows 120 days for review, discovery and
4 resolution of issues by interested parties and consideration by the Authority
5 between the filing date and the implementation of the annual rate change on
6 January 1st.

7 **Q. WHY DID THE COMPANY CHOOSE A JUNE ENDING HISTORIC**
8 **BASE PERIOD?**

9 A. The Company selected the June ending Historic Base Period and September 1
10 Annual Filing Date for its annual mechanism because those dates allow the
11 Forward Looking Test Year to be built with less emphasis on inflation factors.
12 The methodology for forecasting a Forward Looking Test Year relies on budgeted
13 data to the extent it is available and inflation factors when appropriate budget data
14 are not available. The selection of the June ending Historic Base Period and
15 September 1 Annual Filing Date ensures that the first nine months of the Forward
16 Looking Test Year can rely on the Company's recently completed budget without
17 inflation built into the forecast.

18 **Q. HOW DOES THE COMPANY PROPOSE TO HANDLE DEPRECIATION**
19 **RATES IN SUBSEQUENT ANNUAL RATE REVIEW FILINGS?**

20 A. Prudent rate making and accounting requires that depreciation rates be updated
21 periodically. The Company typically endeavors to update its depreciation rates in
22 its various operating divisions and entities housing shared assets (such as the
23 Kentucky Mid-States General Office and SSU) every 4-6 years. For various

1 reasons, that timeframe may be extended due to rate proceeding filing schedules
2 or other circumstances. The Company is not proposing to change depreciation
3 rates in this filing. However, the Company does plan to conduct depreciation
4 studies in the future consistent with prudent accounting and rate making
5 procedures. In the event it conducts a depreciation study for its Tennessee
6 operations or any of the entities that house shared assets that support Tennessee
7 operations, the Company will plan to file the depreciation study with the TRA and
8 Consumer Advocate and ask that the rates contained in the study be approved for
9 its next annual review. Following any necessary discovery, rebuttal and ultimate
10 approval of new rates, the Company will plan to calculate depreciation expense
11 using the newly approved rates in its subsequent annual rate review filing. To
12 assist with review, the Company will file any new depreciation study when it is
13 completed, rather than waiting until it makes its September 1 annual review filing.

14 **Q. PLEASE EXPLAIN “NEW MATTERS” AS REFERENCED IN GKW-2.**

15 A. These are new issues, adjustments, or ratemaking topics (collectively, “New
16 Matters”) that would affect the annual filing and for which there is no prior
17 determination regarding Atmos Energy by the Authority.
18

19 **V. BUDGETING PROCESS**

20 **Q. WHAT ARE THE OBJECTIVES OF THE COMPANY’S O&M**
21 **BUDGETING PROCESS?**

22 A. The objectives are to: (1) formalize the process of identifying the anticipated costs
23 of operating and maintaining Atmos Energy’s systems each year; (2) ensure that

1 all policies and procedures associated with the annual budgeting process are
2 consistently adhered to by the functional managers and officers; (3) assess the
3 appropriateness of routine maintenance requirements and non-capital
4 expenditures proposed by the functional managers and officers to ensure that the
5 amounts do not exceed a level necessary to deliver safe, reliable, and efficient
6 natural gas service to the Company's customers; (4) ensure that the O&M budget
7 properly reflects our strategic operational and financial plans; and (5) create
8 realistic budgets that will be followed and will as accurately as possible predict
9 the company's actual O&M expenses over the budget time period. These
10 objectives are applicable to the Company as a whole (including SSU) as well as to
11 its various division, state, and local level operations.

12 **Q. CAN YOU DESCRIBE THE COMPANY'S O&M BUDGETING**
13 **PROCESS?**

14 A. Yes. O&M costs are budgeted on a fiscal year basis, which begins on October 1
15 of each year (consistent with the seasonal operations of our business) and runs
16 through September 30 of the following year. Preparation of operating and capex
17 budgets for a fiscal year formally begins in late May of each year and culminates
18 with completion of final budgets in August, just prior to the beginning of the
19 fiscal year. Budget preparation is based on meeting the five objectives described
20 in my preceding answer. Budgets are approved at multiple levels beginning with
21 supervisor/managers up through division leadership. Additional reviews are
22 performed by corporate executive operations management and their staff. High
23 level reviews of the division budgets are also performed by the Company's senior

1 executives who are presiding members of the Company's Management
2 Committee. The Board of Directors must review and approve the total Company
3 budget before finalization and implementation. This approval typically occurs in
4 September of each year.

5 **Q. WHAT ROLE DOES THE O&M BUDGETING PROCESS PLAY IN THE**
6 **COMPANY'S FINANCIAL PLANNING?**

7 A. Atmos Energy's Business Planning and Analysis Department is responsible for
8 financial planning at the enterprise level. That department receives direction from
9 the Board of Directors concerning forward-looking financial objectives for the
10 Company. Business Planning and Analysis is responsible, with significant input
11 and collaboration from division leadership, for translating those enterprise targets
12 into a financial plan for each division and rate jurisdiction. It is the collaboration
13 between Business Planning and Analysis and division leadership that ensures that
14 all five of the objectives described above are met each year. Spending targets are
15 established as a result of this collaboration.

16 **Q. HOW IS THE OPERATIONS LEADERSHIP OF THE COMPANY**
17 **INVOLVED IN THE PROCESS?**

18 A. The division finance department communicates certain budget guidelines such as
19 average wage increase percentages and anticipated benefits rates to managers and
20 supervisors (cost center owners). Each cost center owner is responsible for
21 building his or her department's budget and submitting it for review and approval
22 along the appropriate approval chain. The Division finance department budgets
23 several items on behalf of the entire Division such as bad debt provision, legal

1 expenses, etc. An iterative process involving Division leadership, the finance
2 department and the cost center owners ultimately produces an O&M budget that
3 meets the needs of our operations, ensures that we operate safely, reliably and
4 efficiently, and allows the Division to contribute to the financial success of Atmos
5 Energy. This process is used to develop the direct O&M budget for Tennessee, as
6 well as the Division's general office O&M budget. A portion of the Division's
7 general office O&M budget is allocated to Tennessee in accordance with the
8 allocation methods addressed in the Company's Cost Allocation Manual filed
9 with the testimony of Company witness Jason Schneider.

10 **Q. SO FAR YOU HAVE DESCRIBED THE O&M BUDGETING PROCESS.**
11 **CAN YOU EXPLAIN HOW THE BUDGET IS PREPARED WITHIN THE**
12 **PARAMETERS OF THIS PROCESS?**

13 A. Yes. The O&M budget is prepared by type of cost element, such as labor,
14 benefits, transportation, rents, office supplies, etc. Within each cost element we
15 budget expenses at the sub-account level. The prior year's actual costs, year to
16 date actual costs, and budgeted costs for the remainder of the fiscal year are used
17 as guidelines for budgeting by functional managers and officers. The budgets are
18 prepared using a web based software tool called PlanIt. This tool allows cost
19 center owners to enter their budgets and allows Kentucky/ Mid-States Division
20 management to review budgets using a number of standard and ad hoc reports.

21 **Q. ARE THESE BUDGETS PREPARED BY FERC ACCOUNT?**

22 A. No. In our experience, FERC accounts do not provide a sufficient level of detail
23 to enable us to understand the costs within each account. For budgeting purposes

1 (and subsequent managing of expenses), we need individualized expense types
2 that relate to the operation of each cost center. FERC accounts do not provide
3 that level of detail. However, when we incur costs, we do identify our
4 expenditures by FERC account as well as expense type. This provides a timely
5 analysis of the type of charges being expensed by FERC account.

6 **Q. HOW DOES ATMOS ENERGY CONVERT ITS O&M BUDGET BY COST**
7 **ELEMENT INTO FERC ACCOUNTS?**

8 A. To convert our budget and forecast to FERC accounts, Historic Base Period actual
9 expenditures are downloaded from the general ledger by FERC account and cost
10 element. A calculation was then made to determine within each cost element type
11 the percentage of spending attributable to each FERC account. Each percentage
12 factor was then applied to the Forward Looking Test Year forecast by cost type to
13 develop a forecast by FERC account.

14 **Q. CAN YOU DESCRIBE THE SSU (SHARED SERVICES UNIT)**
15 **BUDGETING PROCESS?**

16 A. The annual budget for SSU O&M is developed using the same methods,
17 processes, and controls that I have described above. SSU is, however, slightly
18 different.

19 **Q. HOW DOES SSU DIFFER?**

20 A. Perhaps the easiest way to explain the SSU budgeting process is to begin with a
21 brief explanation of how SSU is organized. SSU is comprised of functional
22 service groups such as planning and budgeting, accounting, legal, rates,
23 information technology, gas supply, customer support, risk management, etc.

1 Each functional service group is comprised of one or more cost centers, such as
2 accounting which, at the high level, consists of the Company's controller, general
3 accounting services, tax services, revenue accounting, and financial reporting.
4 These cost centers may have additional cost centers below them that roll up into
5 the cost center for total budgeting purposes, such as plant accounting within
6 general accounting. The Business Planning and Analysis group works with and
7 supports the Company's utility divisions, subsidiaries, and SSU cost center
8 owners in the development of their annual budgets.

9 Each SSU cost center owner, whether an officer, managerial director,
10 manager or supervisor of the Company, is responsible for developing his or her
11 annual budget as part of the Company-wide annual budgeting process, except for
12 certain pre-determined costs developed by planning and budgeting or another
13 group that has knowledge of the pre-determined cost. An example of a pre-
14 determined cost is the allocated portion of corporate office rent. Pre-determined
15 costs are provided to cost center owners for inclusion in their cost center budgets.

16 Once an SSU cost center budget has been prepared, it is subject to the
17 same managerial review and approval processes that are used for the budgets of
18 the Company's utility divisions and subsidiaries. Once approved, the SSU cost
19 center's budget is subject to the same ongoing control processes, including
20 variance monitoring, that I have describe below.

21 **Q. WHAT ARE THE OBJECTIVES OF THE COMPANY'S CAPITAL**
22 **BUDGETING PROCESS?**

23 A. The objectives are to:

- 1 (1) Formalize the process of identifying construction needs and prioritizing
- 2 capital expenditures;
- 3 (2) Assess the economic feasibility of individual construction projects;
- 4 (3) Determine overall capital requirements for the planning periods;
- 5 (4) Reassess long term system maintenance requirements annually;
- 6 (5) Review past construction projects and work practices, and apply procedural
- 7 improvements as appropriate; and
- 8 (6) Develop realistic budgets that will be followed and with as much accuracy as
- 9 possible predict the Company's actual capital expenditures during the budget
- 10 period.

11 **Q. PLEASE DESCRIBE THE PLANNING AND BUDGET PROCESS FOR**
12 **THE COMPANY'S CAPITAL INVESTMENT PROGRAM.**

13 A. The annual timing of the Capex budgeting process mirrors the O&M budgeting
14 process. The process is initiated within the Division by a request for a "bottom-
15 up" submission of projects from our operations supervisors and operations
16 managers in Tennessee. All proposed projects, vehicles, and equipment must be
17 identified at a high level by need and cost, and all budgets are prepared based
18 upon meeting the six objectives described above. The proposed projects,
19 vehicles, and equipment are reviewed by the KY/Mid-States Division's regional
20 vice presidents of operations for collaborative agreements between the regional
21 vice presidents, operations managers, and Technical Services Department. After
22 review, additional information is requested for projects that are determined to be
23 the most eligible for funding, and more detailed documentation is requested from

1 the operations and technical services managers on those particular projects.
2 Typically the process is largely complete by late June when projects are entered
3 into the Atmos Energy capital budget system (PlanIt), although finalization of
4 capital expenditures is not completed until late July or early August. During this
5 time, the agreed-to projects have been further substantiated to ensure they meet
6 the appropriate financial criteria and the stated objectives.

7 The final proposed budget must be reviewed by the Division's senior
8 management, including the Division President. Additional reviews are performed
9 by corporate executive operations management and their staff. High level reviews
10 of the division budgets are also performed by the Company's senior executives
11 who are presiding members of the Company's Management Committee. Upon
12 approval by the Company's Board of Directors, typically in September of each
13 year, all approved projects are transferred into the Atmos Energy capital tracking
14 system (POWERPLANT) and are ready for appropriation.

15 **Q. HOW DOES ATMOS ENERGY PRIORITIZE ITS CAPITAL**
16 **EXPENDITURES?**

17 A. Our priorities for capital expenditure, listed in order of importance, are:

- 18 1. Public Safety;
- 19 2. System Capacity and Reliability;
- 20 3. Customer Growth;
- 21 4. Facilities Maintenance;
- 22 5. Public Works; and
- 23 6. Support of Long Term Technological Programs.

1 **Q. WHAT FINANCIAL CRITERIA ARE THE MOST SIGNIFICANT IN**
2 **APPROVING A PROJECT DURING THE CAPITAL BUDGETING**
3 **PROCESS?**

4 A. We begin work with an overall capital spending goal, which we try to work
5 within, although variations are permitted if justified. We also use key investment
6 criteria to evaluate projects. Any expenditure above targeted levels must be
7 justified.

8 **Q. MUST ALL PROJECTS MEET THE SAME FINANCIAL CRITERIA?**

9 A. No. We separate projects into growth and non-growth capital expenditures.
10 Growth projects are revenue-producing investments for which we can identify a
11 stream of revenues, cash flow, return, payback and other standard investment
12 criteria. Non-growth capital expenditures involve system integrity, equipment,
13 structures, pipeline integrity, system maintenance and reliability projects which
14 are evaluated on a cost/benefit basis. Obviously, there are certain non-growth
15 expenditures that do not impact public safety that can be scheduled into our five-
16 year investment program to ensure that we properly maintain our system while
17 still operating within overall cash flow constraints. Expenditures that impact
18 public safety always have had and will continue to have the highest priority. We
19 take our obligation to build and operate a safe and reliable gas system very
20 seriously. Finally, there are also a number of projects we must fund which we
21 have little control over as to timing, such as public works projects and highway
22 relocations.

23 **Q. PLEASE DESCRIBE SSU CAPEX BUDGETING.**

1 A. The SSU Capex budget is developed using the same general methods and
2 processes employed for the Kentucky/Mid-States Division's Capex budget. There
3 are, however, some notable differences.

4 **Q. PLEASE DESCRIBE THE DIFFERENCES.**

5 A. Although a particular Capex item may be budgeted by an SSU cost center owner,
6 such as the purchase of new office equipment, the majority of SSU Capex costs
7 consists of information technology hardware and software systems. These costs
8 are budgeted in the SSU Information Technology ("IT") costs centers. For
9 example, if tax services required a new property tax management system, then the
10 IT group would work with tax services to budget the costs of purchasing or
11 developing and implementing the new system. IT will include these costs as part
12 of the IT Capex budget for SSU information technology capital projects. The
13 SSU Capex budget is subject to the same managerial review and pre-approval
14 processes as that of the operating divisions.

15 **Q. WHY IS THIS DISCUSSION OF THE BUDGETING PROCESS**
16 **IMPORTANT AND RELEVANT TO THIS APPLICATION?**

17 A. Consistent with previous cases in Tennessee, the Forward Looking Test Year
18 relies heavily on the Company's most recently completed budget for O&M and
19 capital expenditures in order to forecast cost of service. Thus the process by
20 which we construct annual operating expense and Capex budgets is relevant and
21 the integrity and rigor involved in those processes is critical in establishing
22 credibility in the Company's annual filing.

23

1 **VI. CONTROL AND MONITORING OF O&M AND CAPEX**

2 **Q. DOES THE COMPANY EMPLOY ANY MECHANISMS TO MONITOR**
3 **AND CONTROL O&M ACCORDING TO BUDGETED LEVELS?**

4 A. Yes. Atmos Energy utilizes variance monitoring to ensure financial quality
5 control of O&M expenses by formalizing the analysis of variances by cost type
6 and cost center. On a quarterly basis, we present our Division's actual to budget
7 variances with explanation to the Company's Management Committee, SSU
8 department heads, select Board of Directors members and external auditors at a
9 formal Quarterly Performance Review. The goal is to keep all levels of
10 management informed of our O&M spending in comparison to budgeted amounts,
11 in order to allow management to react to unanticipated events on a timely basis.

12 **Q. ARE O&M VARIANCES EVALUATED MORE FREQUENTLY THAN**
13 **ON A QUARTERLY BASIS?**

14 A. Yes. Each Division finance department conducts a thorough review of O&M
15 actual to budget variances each month.

16 **Q. PLEASE DESCRIBE YOUR MONTHLY VARIANCE REVIEW**
17 **PROCESS.**

18 A. We begin by examining, at the Division level, significant variances by cost type
19 (labor, benefits, materials, rents, etc.). Significant variances are researched until
20 an explanation is found. Reasonable explanations could include events that
21 affected the entire Division or a particular cost center or region. In some cases,
22 clarifying information is sought from cost center owners to explain unusual
23 variances or transactions. For some cost types, clarifying analysis is provided by

1 SSU departments. If errors are found, they are most often corrected in the current
2 month's business. Occasionally, however, errors are discovered after the books
3 are closed, and, depending on materiality, they are corrected in the following
4 month's business.

5 **Q. DOES ANYONE ELSE WITHIN THE DIVISION HAVE THE ABILITY**
6 **TO MONITOR OR REVIEW O&M VARIANCES?**

7 A. In addition to the research conducted by the finance department, each cost center
8 owner has the ability to run variance reports throughout the monthly closing
9 process. Because cost center owners are held accountable for significant
10 variances to budget, they conduct their own research and often contact the finance
11 department when they find errors or have questions about the expenses that were
12 charged to their cost centers.

13 **Q. WHAT CONTROLS AND REPORTING ARE INVOLVED IN THE**
14 **MONTHLY CLOSE PROCESS REGARDING O&M VARIANCES?**

15 A. Once the monthly books are closed, the SSU Financial Reporting department in
16 Dallas publishes (electronically) the monthly Atmos Energy Financial Package.
17 This package details the financial performance for Atmos Energy at the corporate
18 and each division level. For each division, the report includes a comparative
19 income statement, operating statistics page (volumes, total spending), O&M detail
20 page, balance sheet highlights page, and financial highlights page. The financial
21 highlights page reports the Division's monthly and year-to-date (YTD)
22 performance versus budget for net income, gross profit, direct O&M and capital
23 spending. The Division Finance VP provides narrative comments on this page to

1 describe our monthly and YTD variances. Once complete, this Financial Package
2 is available to all Atmos Energy officers and Board members for review and is an
3 official SOX control document of the Company. Once the package is complete,
4 the Division Finance VP completes an online questionnaire generated by our SOX
5 Compliance Tool certifying that his department has conducted a thorough review
6 of the division's financial performance and the Financial Package and addressed
7 all matters therein. The Company's external auditors look for this certification as
8 evidence of SOX compliance.

9 After meeting the Financial Package control requirement, the finance
10 department publishes (electronically) detailed O&M reports that include monthly
11 and YTD variances for each cost center and these reports are then made available
12 to each cost center owner and their respective managers (managers, Division Vice
13 Presidents, Division President). This activity ensures that each cost center owner
14 receives the same information in the same format each month in a timely fashion
15 in order to make operational decisions and manage our operations effectively and
16 efficiently.

17 **Q. WHAT ARE THE GOALS OF THE COMPANY'S PROCESS OF**
18 **CONTROLLING AND MONITORING CAPITAL EXPENDITURE**
19 **VARIANCES?**

20 A. Variances from budgeted amounts are inherent in the process of making capital
21 expenditures. Our variance monitoring process exists to institute financial quality
22 control by formalizing the analysis of variances by responsibility center in a
23 process that identifies year-to-date spending variances by project. These reports

1 are received and reviewed every month at the business unit level and on a
2 quarterly basis at the corporate level. The goal is to keep all levels of
3 management informed of spending by category or project relative to budgeted
4 levels and to ensure that corrective action is initiated on a timely basis. This
5 supports decision-making related to the cost and appropriate management of
6 current and future capital projects.

7 **Q. PLEASE DESCRIBE THE COMPANY'S PROCESS FOR**
8 **CONTROLLING AND MONITORING CAPITAL EXPENDITURE**
9 **VARIANCES.**

10 A. The Company's capital budgeting system maintains projects in two broad
11 categories – Blanket Functionals and Specific Projects. The Blanket Functionals
12 include total capital authorizations of a similar type such as new services, leak
13 repair, short main replacements, small integrity/reliability projects, etc. Specific
14 projects are uniquely identified, such as a specific highway relocation project,
15 replacement of work equipment, or some larger significant integrity/reliability
16 project.

17 Once a project has been entered in the capital budget system an
18 appropriation request is routed for approval. Projects are then monitored to
19 ensure they stay within budgeted levels. If during the course of a project, field
20 management identifies that the costs of the project will exceed approved amounts,
21 a request for supplemental funding may be submitted. All expenditures above
22 authorized appropriation, and all expenditures for unbudgeted projects or

1 variances on budgeted and approved projects, must be approved at the appropriate
2 levels within the Company.

3 Each month, various project variance reports are published. Each manager
4 is responsible for a budget center and held accountable for managing the overall
5 approved capital budget.

6 **Q. WHY IS THIS DISCUSSION OF CONTROLS IMPORTANT AND**
7 **RELEVANT TO THIS APPLICATION?**

8 A. Consistent with previous cases in Tennessee, the Forward Looking Test Year
9 relies heavily on the Company's most recently completed budget for O&M and
10 capital expenditures in order to forecast cost of service. Thus the process by
11 which we monitor expenditures and hold leaders accountable for managing the
12 business within the constraints of those budgets is relevant and the integrity and
13 rigor involved in those processes is critical in establishing credibility in the
14 Company's annual filing.

15
16 **VII. CONCLUSION**

17 **Q. DO YOU BELIEVE THAT THE FORWARD LOOKING TEST YEAR**
18 **FORECASTS YOU HAVE PRESENTED ARE THE MOST REASONABLE**
19 **ESTIMATES OF COST OF SERVICE COMPONENTS FOR THIS**
20 **FILING AND FUTURE ANNUAL RATE REVIEW FILINGS?**

21 A. Yes. They are the best estimate we have of the Tennessee jurisdiction's cost of
22 service.

1 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

2 **A. Yes.**

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

IN RE:

ATMOS ENERGY CORPORATION
GENERAL RATE
CASE AND PETITION TO ADOPT
ANNUAL REVIEW MECHANISM
AND ARM TARIFF

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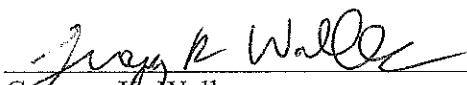
Docket No. 14-XXXXXX

VERIFICATION

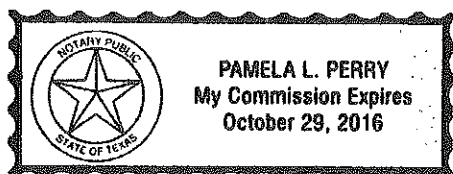
STATE OF TEXAS)

COUNTY OF DALLAS)

I, Gregory K. Waller, being first duly sworn, state that I am the Manager of Rates and Regulatory Affairs for Atmos Energy Corporation, that I am authorized to testify on behalf of Atmos Energy Corporation in the above referenced docket, that the Testimony of Gregory K. Waller in Support of Atmos Energy Corporation's Petition and the Exhibits thereto pre-filed in this docket on the date of filing on this Petition are true and correct to the best of my knowledge, information and belief.


Gregory K. Waller

Sworn and subscribed before me this 24th day of November, 2014




Notary Public

My Commission Expires: 10-29-16

ATMOS ENERGY CORPORATION

Original Sheet No. 34.1

ARM
Annual Review Mechanism

I. Applicable

To all gas sold and transported under tariff services, excluding approved special contracts.

II. Purpose

This Annual Review Mechanism ("ARM") is implemented under the provisions of Tennessee Code Annotated Section 65-5-103(d)(6), which authorizes the Company to opt for an annual review of the Company's rates. Pursuant to this ARM and the annual filings described in section IV.A below, the Company's tariff rates (excluding approved special contract rates) shall be adjusted to provide that the Company earns the authorized return on equity established in the Company's most recent general rate case. The rate adjustments implemented under this mechanism will reflect changes in the Company's revenues, cost of service, and rate base. The ARM may be terminated or modified as provided under Tennessee Code Annotated 65-5-103(d)(6)(D).

III. Definitions

A) **Annual Filing Date** shall be the date the Company will make its annual ARM filing. The Annual Filing Date shall be no later than September 1 of each year.

B) **Historic Base Period** is defined as the twelve month period ending June 30 of each calendar year in which an Annual Filing Date occurs.

C) **Forward Looking Test Year** is defined as the twelve months beginning January 1 of each calendar year following the Annual Filing Date. The rate adjustment resulting from the annual rate review will be effective on bills rendered on and after January 1 of each year.

D) **New Matters** as referenced in this tariff refers to new issues, adjustments or ratemaking topics that would affect the ARM filing for which there is no prior determination regarding the Company by the Authority.

IV. ARM Filing

On the Annual Filing Date each year the Company shall file with the Authority schedules and supporting work papers that reflect the actual annual amounts as reflected on the books and records of the Company for the Historic Base Period as well as the projected amounts expected during the Forward Looking Test Year.

ATMOS ENERGY CORPORATION

Original Sheet No. 34.2

A. Contents of the Annual Filing. The ARM filing shall include:**Schedule 1: Cost of Service**

Summarizes the elements of cost of service, including gas cost expense, operation and maintenance expense, depreciation expense, taxes other than income taxes, return on rate base, income tax, allowance for funds used during construction ("AFUDC") and interest on customer deposits. Compares the total cost of service to revenues at present rates in order to calculate a net revenue deficiency / sufficiency.

Schedule 2: Summary of Revenues at Present Rates

Presents per book revenues for the Historic Base Period and the projected Forward Looking Test Year revenues.

Schedule 3: Cost of Gas

Presents Historic Base Period per books gas cost and the projected Forward Looking Test Year cost of gas. Includes rate making adjustments consistent with the Company's most recent general rate case.

Schedule 4: Operation and Maintenance Expenses

Presents Historic Base Period per books operation and maintenance expense, and the projected Forward Looking Test Year operation and maintenance expense. Includes rate making adjustments consistent with the Company's most recent general rate case.

Schedule 5: Taxes Other than Income

Presents Historic Base Period per books taxes other than income taxes expense, and the projected Forward Looking Test Year taxes other than income taxes expense. Includes rate making adjustments consistent with the Company's most recent general rate case.

Schedule 6: Depreciation and Amortization Expenses

Presents Historic Base Period per books depreciation and amortization expense, and the projected Forward Looking Test Year depreciation and amortization expense. Includes rate making adjustments consistent with the Company's most recent general rate case and adjustments to reflect impact of proposed depreciation rates, if any, as defined in Section IV. B. b.

ATMOS ENERGY CORPORATION

Original Sheet No. 34.3

Schedule 7: Rate Base and Return

Presents the calculation of the Base Period per books rate base, and projected Forward Looking Test Year rate base. The rate base includes original cost of plant, accumulated depreciation, construction work in progress ("CWIP"), storage gas investment, materials and supplies, cash working capital, accumulated deferred income tax ("ADIT"), customer advances, customer deposits, accumulated interest on customer deposits and deferred rate case expenses. Includes rate making adjustments consistent with the Company's most recent general rate case.

Schedule 8: Computation of State Excise and Income Taxes

Presents the calculation of state excise taxes and income taxes on the required return on rate base for the Historic Base Period and Forward Looking Test Year.

Schedule 9: Overall Cost of Capital

Presents the calculation of the overall cost of capital based on the capital structure, debt cost rates and the required rate of return on equity as defined in section IV. B. e.

Schedule 10: Rate of Return

Presents the calculation of a rate of return on rate base and a rate of return on the equity financed portion of rate base for the Base Period and the Forward Looking Test Year, with costs and revenues as presented in Schedules 2 through 9.

Schedule 11: Proof of Revenues and Calculation of Rates

Presents the forecasted billing determinants and calculation of new tariff rates by customer class and rate schedule for the Forward Looking Test Year consistent with the cost of service and net revenue deficiency / sufficiency presented in Schedule 1.

B. Revenue Requirements. In presenting data that demonstrates the Forward Looking Test Year revenue requirements:

- a. Rate Base and Cash Working Capital requirements will be reflected in a manner consistent with the Company's most recent general rate case. The Company will use the factors derived from the Lead/Lag study performed in its most recent general rate case in calculating cash working capital requirements.
- b. Depreciation expenses shall reflect the depreciation rates approved by the Authority in the Company's most recent general rate case. If and when the Company performs a new depreciation study, the new study will be filed with the Authority, and updated depreciation rates will be utilized in the next annual review under this tariff.

ATMOS ENERGY CORPORATION

Original Sheet No. 34.4

- c. Forward Looking Test Year Operating Expenses (O&M, Taxes other than Income Taxes, and Income Taxes) will be projected using methodologies consistent with the Company's most recent general rate case.
- d. The Historic Base Period data shall include actual revenues by billing component, and the Forward Looking Test Year data shall reflect adjustments to forecast revenue billing determinants based on the revenue forecasting methodologies that were used in the Company's most recent general rate case for projecting the number of customers and average customer use, unless modified in the current Annual Review Mechanism.
- e. Cost of Capital will be calculated using the ROE defined in the Company's most recent general rate case. The Company's cost of debt and capital structure will be calculated using methodologies consistent with the Company's most recent general rate case.
- f. Schedules filed pursuant to this mechanism shall reflect applicable accounting and pro forma adjustments used in the Company's most recent general rate case as well as other adjustments required to account properly for atypical, unusual, or nonrecurring events.

C. New Matters. If New Matters arise, the Company, TRA Staff, and the Consumer Advocate will endeavor to reach a resolved treatment, or if necessary, will seek a ruling from the Authority.

V. Attestation

A sworn statement shall be filed by a Company officer responsible for Tennessee Operations affirming that the filed schedules are in compliance with the provisions of this mechanism and are true and correct to the best of his/her knowledge, information and belief. No testimony in addition to such attestation in support of the proposed adjustments shall be necessary at the time of the filing.

VI. Rate Adjustment

Pursuant to the provisions of Tennessee Code Annotated 65-5-103(d)(6)(C), based upon the Forward Looking Test Year, the Company's tariff rates shall be adjusted to provide for the Company to earn the authorized return on equity established in the Company's most recent general rate case. All tariff rates shall be adjusted in proportion to the relative base revenue share of each, as approved in the Company's most recent general rate case. The Company shall file revised tariffs reflecting the new rates. The revised tariffs and new rates shall be effective for bills rendered on or after the January 1 immediately following the Annual Filing Date, except that the Company may implement the new weather normalization adjustment factors effective on October 1. Approved special contract rates shall be exempt from this ARM and shall not be adjusted hereunder.