IN THE TENNESSEE REGULATORY AUTHORITY
AT NASHVILLE, TENNESSEE

IN RE:	)	
	)	
ATMOS ENERGY CORPORATION	)	
GENERAL RATE CASE AND	)	**DOCKET NO. 14-00146**
PETITION TO ADOPT ANNUAL	)	
REVIEW MECHANISM AND ARM	)	
TARIFF	)	

ATTACHMENTS TO INFORMAL DISCOVERY REQUEST OF THE CONSUMER ADVOCATE

Pursuant to the Hearing Officer's order to file all information exchanged between parties, attached hereto are the documents provided to Atmos Energy Corporation ("Atmos Energy") on February 25, 2015, in connection with the Consumer Advocate's Informal Discovery Request Set Number 5, Question No. 5-14, and, as labelled by Atmos Energy in its response on March 17, 2015, Question 1-99 (for ease of reference, Atmos Energy's response also is attached to this filing as Exhibit F). Atmos Energy did not include the attached documents in its response on March 17, 2015. The attached documents are:

Exhibit A - Ruling Request for Atmos Energy Corporation dated January 9, 2015.

Exhibit B - Letter from the Kentucky Attorney General to the Kentucky Public Service Commission dated December 12, 2014.

Exhibit C - Letter from Atmos Energy's legal counsel to the Kentucky Public Service Commission dated December 12, 2014.

Exhibit D - Supplemental and Corrected Direct Testimony of Bion C. Ostrander, public version, on behalf of the Kentucky Attorney General dated November 18, 2013.

Exhibit E - Rebuttal Testimony of Pace McDonald on behalf of Atmos Energy dated November 18, 2013.

Exhibit F – Atmos Energy's Response to Consumer Advocate's Informal Discovery Request Set Number 5, Question No. 5-14, and, as labelled by Atmos Energy in its response on March 17, 2015, Question 1-99.

RESPECTFULLY SUBMITTED,

WAYNE M. IRVIN (BPR #30946)
Assistant Attorney General
Office of the Tennessee Attorney General
Consumer Advocate and Protection Division
P.O. Box 20207
Nashville, Tennessee 37202-0207
(615) 741-8733

Dated: March 23, 2015.

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served via U.S. Mail or electronic mail upon:

Patricia Childers
Vice President
Rates & Regulatory Affairs
Mid-States Division
Atmos Energy Corporation
810 Crescent Centre Drive, Ste. 600
Franklin, TN 37067-6226

A. Scott Ross, Esq.
Neal & Harwell, PLC
2000 One Nashville Place
150 Fourth Avenue North
Nashville, TN 37219-2498

Ellen T. Weaver, Esq.
Senior Attorney
Atmos Energy Corporation
P.O. Box 650205
Dallas, TX 75265-0205

This the 23d day of March, 2015.

Wayne M. Irvin

EXHIBIT

A

MILLER CHEVALIER

RECEIPT COPY

James I. Warren
Member
(202) 626-5959
jwarren@milchev.com

January 9, 2015

VIA HAND DELIVERY

Associate Chief Counsel
Passthroughs & Special Industries
Courier's Desk
Internal Revenue Service
Attn: CC:PA:LPD:DRU, Room 5336
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Ruling Request for Atmos Energy Corporation (EIN# 75-1743247)

Dear Sir or Madam:

We represent Atmos Energy Corporation (EIN# 75-1743247) in connection with the submission of the enclosed Private Letter Ruling request relating to the application of the depreciation normalization rules of §168(i)(9) of the Internal Revenue Code of 1986, as amended ("Code"), and Treas. Reg. §1.167(l)-1. A check in the amount of $19,000 is enclosed which represents the user fee associated with this request.

Please do not hesitate to contact me at 202-626-5959 if you have any questions.

Sincerely

James I. Warren

Enclosures

MILLER CHEVALIER

James I. Warren
Member
(202) 626-5959
jwarren@milchev.com

January 9, 2015

VIA HAND DELIVERY

Associate Chief Counsel
Passthroughs & Special Industries
Courier's Desk
Internal Revenue Service
Attn: CC:PA:LPD:DRU, Room 5336
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Ruling Request for Atmos Energy Corporation (EIN# 75-1743247)

Dear Sir or Madam:

We represent Atmos Energy Corporation (EIN# 75-1743247) in connection with the submission of the enclosed Private Letter Ruling request relating to the application of the depreciation normalization rules of §168(i)(9) of the Internal Revenue Code of 1986, as amended ("Code"), and Treas. Reg. §1.167(l)-1. A check in the amount of $19,000 is enclosed which represents the user fee associated with this request.

Please do not hesitate to contact me at 202-626-5959 if you have any questions.

Sincerely

James I. Warren

Enclosures

Check for User Fee

AMARILLO NATIONAL BANK
Amarillo, TX

NO: [redacted]

Atmos Energy Corporation
PO Box 650205
Dallas TX 75265-0205

CHECK DATE	CHECK NUMBER	CHECK AMOUNT
07-Jan-15	[redacted]	*********19,000.00

Void After 90 Days

PAY: Nineteen Thousand Dollars And Zero Cents**********

TO THE ORDER OF INTERNAL REVENUE SERVICE
1111 CONSTITUTION AVE NW
ATTN: CC:PA:LPD:DRU ROOM 5336
WASHINGTON DC 20224
United States

AUTHORIZED SIGNATURE

[redacted]

NO. [redacted]

DATE: 06-Jan-15 **VENDOR NAME:** INTERNAL REVENUE SERVICE **VENDOR No:** 209524

INVOICE No. / DESCRIPTION	INVOICE DATE	AMOUNT	DISCOUNT AMOUNT	NET AMOUNT
412869660 SH Sarah Stojak - 2015 District Of Col	06-JAN-15	19,000.00	0.00	19,000.00
		19,000.00	0.00	19,000.00

PLEASE DETACH AND RETAIN THIS STATEMENT AS YOUR RECORD OF PAYMENT.

[redacted]

Checklist

CHECKLIST

IS YOUR LETTER RULING REQUEST COMPLETE?

INSTRUCTIONS

The Service will be able to respond more quickly to your letter ruling request if it is carefully prepared and complete. Use this checklist to ensure that your request is in order. Complete the four items of information requested before the checklist. Answer each question by circling "Yes," "No," or "N/A." When a question contains a place for a page number, insert the page number (or numbers) of the request that gives the information called for by a "Yes" answer to a question. **Sign and date the checklist (as taxpayer or authorized representative) and place it on top of your request.**

If you are an authorized representative submitting a request for a taxpayer, you must include a completed checklist with the request or the request will either be returned to you or substantive consideration of it will be deferred until a completed checklist is submitted. **If you are a taxpayer preparing your own request without professional assistance, an incomplete checklist will not cause the return of your request or defer substantive consideration of your request.** You should still complete as much of the checklist as possible and submit it with your request.

TAXPAYER'S NAME	Atmos Energy Corporation
TAXPAYER'S I.D. NO.	75-1743247
ATTORNEY/P.O.A.	James I. Warren
PRIMARY CODE SECTION	168

CIRCLE ONE	**ITEM**
(Yes) No	1. Does your request involve an issue under the jurisdiction of the Associate Chief Counsel (Corporate), the Associate Chief Counsel (Financial Institutions and Products), the Associate Chief Counsel (Income Tax and Accounting), the Associate Chief Counsel (International), the Associate Chief Counsel (Passthroughs and Special Industries), the Associate Chief Counsel (Procedure and Administration), or the Associate Chief Counsel (Tax Exempt and Government Entities)? *See* section 3 of Rev. Proc. 2015–1, this revenue procedure. For issues under the jurisdiction of other offices, *see* section 4 of Rev. Proc. 2015–1. (Hereafter, all references are to Rev. Proc. 2015–1 unless otherwise noted.)
(Yes) No	2. Have you read Rev. Proc. 2015–3, 2015–1 and Rev. Proc. 2015–7, 2015–1, this bulletin, to see if part or all of the request involves a matter on which letter rulings are not issued or are ordinarily not issued?
Yes No (N/A)	3. If your request involves a matter on which letter rulings are not ordinarily issued, have you given compelling reasons to justify the issuance of a letter ruling? Before preparing your request, you may want to call the branch in the Office of Associate Chief Counsel (Corporate), the Office of Associate Chief Counsel (Financial Institutions and Products), the Office of Associate Chief Counsel (Income Tax and Accounting), the Office of Associate Chief Counsel (International), the Office of Associate Chief Counsel (Passthroughs and Special Industries), the Office of Associate Chief Counsel (Procedure and Administration), or the Office of Associate Chief Counsel (Tax Exempt and Government Entities) responsible for substantive interpretations of the principal Internal Revenue Code section on which you are seeking a letter ruling to discuss the likelihood of an exception. For matters under the jurisdiction of— (a) the Office of Associate Chief Counsel (Corporate), the Office of Associate Chief Counsel (Financial Institutions and Products), the Office of Associate Chief Counsel (Income Tax and Accounting), the Office of Associate Chief Counsel (Passthroughs and Special Industries), or the Office of Associate Chief Counsel (Tax Exempt and Government Entities), the Office of the Associate Chief Counsel (Procedure and Administration), the appropriate branch to call may be obtained by calling (202) 317-5221 (not a toll-free call); (b) the Office of the Associate Chief Counsel (International), the appropriate branch to call may be obtained by calling (202) 317-6888 (not a toll-free call).

Yes No(N/A) Page ___

4. If the request involves a retirement plan qualification matter under § 401(a), § 409, or § 4975(e)(7), have you demonstrated that the request satisfies the three criteria in section 4.02(12) of Rev. Proc. 2015–3, this Bulletin, for a ruling?

Yes No(N/A) Page ___

5. If the request deals with a completed transaction, have you filed the return for the year in which the transaction was completed? *See* section 5.01.

Yes(No)

6. Are you requesting the letter ruling on a hypothetical situation or question? *See* section 6.12.

Yes(No)

7. Are you requesting the letter ruling on alternative plans of a proposed transaction? *See* section 6.12.

Yes(No)

8. Are you requesting the letter ruling for only part of an integrated transaction?

Yes(No)

9. Are you requesting a letter ruling under the jurisdiction of Associate Chief Counsel (Corporate) on a significant issue (within the meaning of section 3.01(48) of Rev. Proc. 2015–3, this Bulletin) with respect to a transaction described in § 332, 351, 355, or 1036 or a reorganization within the meaning of § 368? *See* section 6.03.

Yes(No)

10. Are you requesting the letter ruling for a business, trade, industrial association, or similar group concerning the application of tax law to its members? *See* section 6.05.

Yes(No)

11. Are you requesting the letter ruling for a foreign government or its political subdivision? *See* section 6.07.

(Yes) No Pages 1-8

12. Have you included a complete statement of all the facts relevant to the transaction? *See* section 7.01(1).

Yes No(N/A)

13. Have you submitted with the request true copies of all wills, deeds, and other documents relevant to the transaction, and labeled and attached them in alphabetical sequence? *See* section 7.01(2).

Yes No(N/A)

14. Have you submitted with the request a copy of all applicable foreign laws, and certified English translations of documents that are in a language other than English or of foreign laws in cases where English is not the official language of the foreign country involved? *See* section 7.01(2).

(Yes) No

15. Have you included an analysis of facts and their bearing on the issues? Have you included, rather than merely incorporated by reference, all material facts from the documents in the request? *See* section 7.01(3).

(Yes) No Page 29

16. Have you included the required statement regarding whether any return of the taxpayer (or any return of a related taxpayer within the meaning of § 267 or of a member of an affiliated group of which the taxpayer is also a member within the meaning of § 1504) who would be affected by the requested letter ruling or determination letter is currently or was previously under examination, before Appeals, or before a Federal court? *See* section 7.01(4).

(Yes) No Page 29

17. Have you included the required statement regarding whether the Service previously ruled on the same or similar issue for the taxpayer, a related taxpayer, or a predecessor? *See* section 7.01(5)(a).

(Yes) No Page 29

18. Have you included the required statement regarding whether the taxpayer, a related taxpayer, a predecessor, or any representatives previously submitted a request (including an application for change in method of accounting) involving the same or similar issue but withdrew the request before the letter ruling or determination letter was issued? *See* section 7.01(5)(b).

(Yes) No Page 30

19. Have you included the required statement regarding whether the taxpayer, a related taxpayer, or a predecessor previously submitted a request (including an application for change in method of accounting) involving the same or similar issue that is currently pending with the Service? *See* section 7.01(5)(c).

(Yes) No Page 30

20. Have you included the required statement regarding whether, at the same time as this request, the taxpayer or a related taxpayer is presently submitting another request (including an application for change in method of accounting) involving the same or similar issue to the Service? *See* section 7.01(5)(d).

Yes No(N/A) Page ___

21. If your request involves the interpretation of a substantive provision of an income or estate tax treaty, have you included the required statement regarding whether the tax authority of the treaty jurisdiction has issued a ruling on the same or similar issue for the taxpayer, a related taxpayer, or a predecessor; whether the same or similar issue is being examined, or has been settled, by the tax authority of the treaty jurisdiction or is otherwise the subject of a closing agreement in that jurisdiction; and whether the same or similar issue is being considered by the competent authority of the treaty jurisdiction? *See* section 7.01(6).

Yes No(N/A) Page ___

22. If your request is for recognition of Indian tribal government status or status as a political subdivision of an Indian tribal government, does your request contain a letter from the Bureau of Indian Affairs regarding the tribe's status? *See* section 7.01(7), which states that taxpayers are encouraged to submit this letter with the request and provides the address for the Bureau of Indian Affairs.

(Yes) No Page 9-13	23. Have you included the required statement of relevant authorities in support of your views? *See* section 7.01(8).
(Yes) No Page 30	24. Have you included the required statement regarding whether the law in connection with the request is uncertain and whether the issue is adequately addressed by relevant authorities? *See* section 7.01(8).
(Yes) No Page 13-29	25. Does your request discuss the implications of any legislation, tax treaties, court decisions, regulations, notices, revenue rulings, or revenue procedures that you determined to be contrary to the position advanced? *See* section 7.01(9), which states that taxpayers are encouraged to inform the Service of such authorities.
(Yes) No Page 30	26. If you determined that there are no contrary authorities, have you included a statement to this effect in your request? *See* section 7.01(9).
(Yes) No N/A Page 30	27. Have you included in your request a statement identifying any pending legislation that may affect the proposed transaction? *See* section 7.01(10).
(Yes) No	28. Have you included the deletion statement required by § 6110 and placed it on top of the letter ruling request as required by section 7.01(11)(b)?
(Yes) No Page 31	29. Have you (or your authorized representative) signed and dated the request? *See* section 7.01(12).
(Yes) No N/A	30. If the request is signed by your representative or if your representative will appear before the Service in connection with the request, is the request accompanied by a properly prepared and signed power of attorney with the signatory's name typed or printed? *See* section 7.01(14).
(Yes) No Page 32	31. Have you signed, dated, and included the penalties of perjury statement in the format required by section 7.01(15)?
(Yes) No N/A	32. Are you submitting your request in duplicate if necessary? *See* section 7.01(16).
Yes No (N/A) Page ___	33. If you are requesting separate letter rulings on different issues involving one factual situation, have you included a statement to that effect in each request? *See* section 7.02(1).
(Yes) No N/A	34. If you want copies of the letter ruling sent to a representative, does the power of attorney contain a statement to that effect? *See* section 7.02(2).
Yes No (N/A)	35. If you do not want a copy of the letter ruling to be sent to any representative, does the power of attorney contain a statement to that effect? *See* section 7.02(2).
Yes No (N/A)	36. If you are making a two-part letter ruling request, have you included a summary statement of the facts you believe to be controlling? *See* section 7.02(3).
Yes No (N/A) Page ___	37. If you want your letter ruling request to be processed ahead of the regular order or by a specific date, have you requested expedited handling in the manner required by section 7.02(4) and stated a compelling need for such action in the request? *See* section 7 .02(4) of this revenue procedure.
Yes No (N/A) Page ___	38. If you are requesting a copy of any document related to the letter ruling request to be sent by facsimile (fax) transmission, have you included a statement to that effect? *See* section 7.02(5).
(Yes) No N/A Page 31	39. If you want to have a conference on the issues involved in the request, have you included a request for conference in the letter ruling request? *See* section 7.02(6).
(Yes) No	40. Have you included the correct user fee with the request and is your check or money order in U.S. dollars and payable to the Internal Revenue Service? *See* section 15 and Appendix A to determine the correct amount.
Yes No (N/A) Page ___	41. If your request involves a personal, exempt organization, governmental entity, or business-related tax issue and you qualify for the reduced user fee because your gross income is less than $250,000, have you included the required certification? *See* paragraphs (A)(4)(a) and (B)(1) of Appendix A.
Yes No (N/A) Page ___	42. If your request involves a personal, exempt organization, governmental entity, or business-related tax issue and you qualify for the reduced user fee because your gross income is less than $1 million, have you included the required certification? *See* paragraphs (A)(4)(b) and (B)(1) of Appendix A.

Yes No (N/A) Page ____ 43. If you qualify for the user fee for substantially identical letter rulings, have you included the required information? *See* section 15.07(2) and paragraph (A)(5)(a) of Appendix A.

Yes No (N/A) Page ____ 44. If you qualify for the user fee for a § 301.9100 request to extend the time for filing an identical change in method of accounting on a single Form 3115, *Application for Change in Accounting Method,* have you included the required information? *See* section 15.07(4) and paragraph (A)(5)(d) of Appendix A.

Yes No (N/A) 45. If your request is covered by any of the checklists, guideline revenue procedures, notices, safe harbor revenue procedures, or other special requirements listed in Appendix E, have you complied with all of the requirements of the applicable revenue procedure or notice?

(N/A) List other applicable revenue procedures or notices, including checklists, used or relied upon in the preparation of this letter ruling request (Cumulative Bulletin or Internal Revenue Bulletin citation not required).

Yes No (N/A) Page ____ 46. If you are requesting relief under § 7805(b) (regarding retroactive effect), have you complied with all of the requirements in section 11.11?

Yes No (N/A) 47. If you are requesting relief under § 301.9100 for a late entity classification election, have you included a statement that complies with section 4.04 of Rev. Proc. 2009-41, 2009-39 LR.B. 439? *See* section 5.03(5) of this revenue procedure.

Yes No (N/A) 48. If you are requesting relief under § 301.9100, and your request involves a year that is currently under examination or with appeals, have you included the required notification, which also provides the name and telephone number of the examining agent or appeals officer? *See* section 7.01(4) of this revenue procedure.

Yes No (N/A) 49. If you are requesting relief under § 301.9100, have you included the affidavit(s) and declaration(s) required by § 301-9100-3(e)? See § 5.03(1) of this revenue procedure

Yes No (N/A) 50. If you are requesting relief under § 301.9100–3, and the period of limitations on assessment under § 6501(a) will expire for any year affected by the requested relief before the anticipated receipt of a letter ruling, have you secured consent under § 6501(c)(4) to extend the period of limitations on assessment for the year(s) at issue? See § 5.03(2) of this revenue procedure.

(Yes) No 51. Have you addressed your request to the attention of the Associate Chief Counsel (Corporate), the Associate Chief Counsel (Financial Institutions and Products), the Associate Chief Counsel (Income Tax and Accounting), the Associate Chief Counsel (International), the Associate Chief Counsel (Passthroughs and Special Industries), the Associate Chief Counsel (Procedure and Administration), or the Associate Chief Counsel (Tax Exempt and Government Entities), as appropriate? The mailing address is:

Internal Revenue Service
Attn: CC:PA:LPD:DRU
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

If a private delivery service is used, the address is:

Internal Revenue Service
Attn: CC:PA:LPD:DRU, Room 5336
1111 Constitution Ave., NW
Washington, DC 20224

The package should be marked: RULING REQUEST SUBMISSION. Improperly addressed requests may be delayed (sometimes for over a week) in reaching CC:PA:LPD:DRU for initial processing.

Signature

Attorney for Atmos Energy Company
Authorized Representative

Date: 1/8/15

Typed or printed name of person signing checklist

James I. Warren

Deletion Statement

MILLER
CHEVALIER

DELETION STATEMENT

For purposes of Section 6110(c)(1) of the Internal Revenue Code of 1986, as amended, Taxpayer requests the deletion of all names, addresses, EINs, locations, dates, amounts, regulatory bodies and other taxpayer identifying information contained in the attached request for private letter ruling.

Taxpayer reserves the right to review, prior to disclosure to the public, any information related to this request for private letter ruling and to provide redacted copies of any documents to be released to the public.

Date: 1/9/15

James I. Warren
Miller & Chevalier Chartered
Attorney for Atmos Energy Corporation

Private Letter Ruling Request

MILLER CHEVALIER

James I. Warren
Partner
(202) 626-5959
jwarren@milchev.com

January 9, 2015

VIA HAND DELIVERY

Associate Chief Counsel
Passthroughs & Special Industries
Courier's Desk
Internal Revenue Service
Attn: CC:PA:LPD:DRU, Room 5336
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Ruling Request for Atmos Energy Corporation (EIN# 75-1743247)

Dear Sir or Madam:

A ruling is respectfully requested on behalf of Atmos Energy Corporation ("Atmos Energy" or "Taxpayer") regarding the application of the depreciation normalization rules of §168(i)(9) of the Internal Revenue Code of 1986, as amended ("Code"), and Treas. Reg. §1.167(l)-1 (together, "Normalization Rules") to certain accounting and regulatory procedures which are described in detail hereafter.

STATEMENT OF FACTS

Taxpayer

Atmos Energy is incorporated under the laws of Texas and Virginia. Its principal place of business is located at Three Lincoln Center, Suite 1800, 5430 LBJ Freeway, Dallas, Texas 75240, its telephone number is (972) 934-9227 and its taxpayer identification number is 75-1743247. Taxpayer employs the accrual method of accounting and reports on the basis of a fiscal year ending September 30.

Atmos Energy is the common parent of an affiliated group of corporations that join in the filing of a consolidated federal income tax return. This return is filed with the Internal Revenue Service Center in Ogden, Utah and Taxpayer is under the audit jurisdiction of the Large Business and International Division of the Internal Revenue Service ("IRS" or "Service").

Taxpayer's Business

Atmos Energy is engaged primarily in the regulated natural gas distribution business, the regulated transmission and storage businesses and, through affiliates, in other non-regulated natural gas businesses. Its regulated natural gas distribution business delivers natural gas to approximately 3.1 million customers in Colorado, Kansas, Texas, Louisiana, Mississippi, Tennessee, Kentucky, and Virginia.

This ruling request stems from a recent rate case proceeding involving Atmos Energy's gas distribution business in Kentucky ("Atmos KY"). Taxpayer serves approximately 173,000 residential, commercial, and industrial customers in central and western Kentucky. Atmos KY is subject to regulation by the Kentucky Public Service Commission ("KPSC") with respect to the terms and conditions of service and particularly as to the rates it can charge for the provision of service. Its rates are established by the KPSC on a "rate of return" (*i.e.*, cost) basis.

Taxpayer's Accounting for Its Projected Net Operating Loss Carryforward

Taxpayer incurred net operating loss carryforwards ("NOLCs") during its tax years 2009, 2010, 2011 and 2012. In each of those years, Taxpayer claimed accelerated (including bonus)

depreciation to the extent it was available. As of September 30, 2012, Taxpayer' regulated utility operations had produced a federal NOLC of approximately $960 million.

Where an excess of tax deductions over book expenses reduces Taxpayer's positive taxable income, such deductions reduce (*i.e.*, defer) the tax liability it would otherwise pay and, thereby, produce incremental cash flow for use by Taxpayer. For financial reporting purposes, the existence of this incremental cash is recorded in a set of entries which results in crediting (increasing) a reserve for deferred taxes. The following example illustrates the federal income tax-related accounting entries, given the following assumptions: [1]

ASSUMPTIONS	
Pre-tax book income	$1,000
Tax deductions in excess of book expenses	$1,000
Taxable income	$0
Tax rate	35%

ACCOUNTING ENTRIES		
	DR.	CR.
Current tax expense (a/c 409 – income)	$0	
Taxes payable (a/c 236 – balance sheet)		$0
Deferred tax expense (a/c 410 – income)	$350	
Accumulated deferred taxes (a/c 282 and 283 – balance sheet)		$350

[1] The designation "a/c" refers to the account number used by Taxpayer in its accounting records, including its regulated books of account. These account numbers are prescribed by the Federal Energy Regulatory Commission.

In the example, total tax expense is $350, all of which is deferred tax expense. The accumulated deferred income tax ("ADIT") accounts reflect a $350 balance.

However, when Taxpayer incurs a tax net operating loss that results in an NOLC, some portion of the deductions claimed in that period does not, in fact, defer tax. That portion merely creates or increases the NOLC. Thus, while this portion has the capacity to reduce Taxpayer's tax payments in the future, it has not yet done so. When an NOLC occurs, Taxpayer makes a set of accounting entries that reflect these economics. An example follows which illustrates the federal income tax-related accounting entries when an NOLC occurs, given the following assumptions:

ASSUMPTIONS	
Pre-tax book income	$1,000
Tax deductions in excess of book expenses	$2,500
Taxable loss/NOLC	($1,500)
Tax rate	35%

ACCOUNTING ENTRIES		
Basic entries before NOLC impact:	DR.	CR.
Current tax expense (a/c 409 – income)	$0	
Taxes payable (a/c 236 – balance sheet)		$0
Deferred tax expense (a/c 410 – income)	$875	
Accumulated deferred taxes (a/c 282 and 283 – balance sheet)		$875
Entries to reflect the impact of the NOLC:		
Deferred tax assets (a/c 190 – balance sheet)	$525	
Deferred tax expense (a/c 410 – income)		$525

When the two sets of entries described above are combined, the net entries are as follows:

COMBINED ACCOUNTING ENTRIES		
	DR.	CR.
Current tax expense (a/c 409 – income)	$0	
Taxes payable (a/c 236 – balance sheet)		$0
Deferred tax expense (a/c 410 – income)	$350	
Deferred tax assets (a/c 190 – balance sheet)	$525	
Accumulated deferred taxes (a/c 282 and 283 – balance sheet)		$875

In the example, total tax expense is again $350, all of which is deferred tax expense. The deferred income tax expense attributable to the tax deductions in excess of book expenses ($2,500 X 35% or $875) is reduced by the negative deferred income tax expense related to the NOLC ($1,500 X 35% or $525). The combined ADIT accounts reflect a net $350 balance which

consists of two components - $875 in a/c 282 and 283 (deferred tax liability or "DTL") and an offsetting $525 in a/c 190 (deferred tax asset or "DTA").

Taxpayer's Recent Kentucky Rate Case

On May 13, 2013, Taxpayer filed an application with the KPSC to change its rates (Case No. 2013-00148).[2] Its proposed increase was based on a fully forecasted test period consisting of the twelve months ending on November 30, 2014. Taxpayer derived its rate base by applying a 13-month average to its forecasted test period data. Taxpayer updated, amended and supplemented its data several times during the course of the proceedings. In computing its income tax expense element of cost of service, Taxpayer normalized the tax benefits attributable to accelerated depreciation. In the setting of utility rates in Kentucky, a utility's rate base is offset by its ADIT balance. In a Final Order dated April 22, 2014 ("Final Order"), the KPSC approved a rate adjustment for service rendered on or after January 24, 2014. A copy of the Final Order is appended as Attachment 1.

Ratemaking for Taxpayer's NOLCs

In its computation of jurisdictional rate base in the above-referenced rate filing, Taxpayer reflected a reduction of approximately $46 million on account of its projected ADIT balance. This balance included both federal and state ADIT. The amount reflected (1) an allocation of Taxpayer's total utility operation ADIT balance to its Kentucky gas distribution operations and

[2] This filing was accepted as a complete filing on June 24, 2013.

(2) the application of the 13-month average convention used for all elements of rate base. The $46 million amount was comprised of two components: a DTL of approximately $66 million derived from Taxpayer's non-NOLC-related deferred tax items (primarily, its a/c 282 and 283 balances) and a DTA of approximately $20 million attributable to Taxpayer's federal and state NOLCs (reflected in its a/c 190).

In its rate case filing and throughout the proceeding, Taxpayer maintained that the proper amount of ADIT by which its test year rate base should be reduced was the net of its approximately $66 million DTL and its approximately $20 million NOLC-related DTA. It based this position on the fundamental economic fact that this net amount represented the true measure of income taxes actually deferred in connection with the Kentucky gas distribution operation and, hence, it represented the quantity of "cost-free" capital available to that business. Taxpayer further asserted that a failure to incorporate into its ADIT balance calculation the NOLC-related balance in a/c 190 would be inconsistent with the Normalization Rules (discussed in detail hereafter).

During the proceeding, the Kentucky Office of the Attorney General ("AG") argued that Taxpayer should not be permitted to incorporate the tax effect of its NOLC into its ADIT calculation and proposed to reduce rate base by approximately $66 million on account of ADIT instead of the $46 million proposed by Taxpayer. The AG supported its proposal by asserting:

1. The portion of Taxpayer's NOLC-related DTA are increasing over time;

2. If Taxpayer's NOLC expires unused then customers would be paying a return on a benefit that will never exist;

3. The Normalization Rules do not require the recognition of the NOLC-related DTA; and

4. One other regulatory jurisdiction (West Virginia) has ignored a utility's NOLC-related DTA in computing its ADIT balance.

In its Final Order, the KPSC described the disagreement between Taxpayer and the AG regarding the recognition of the NOLC-related DTA in the computation of rate base and concluded:

> The Commission is not persuaded by the AG's argument. While there is some ambiguity in the Treasury regulations cited by the AG and Atmos-Ky. on the subject of NOLCs, we are unable to agree with the AG that a tax normalization violation would not result from a decision to remove NOLCs from Atmos-Ky.'s rate base. The AG has not made a compelling argument for why, from a ratemaking perspective, it would be reasonable to adopt his recommendation.[3]

The KPSC further stated:

> Although we are rejecting the AG's proposal, the aforementioned ambiguity in the governing regulations and the significantly different interpretations of those regulations by the AG and Atmos-KY. cause the Commission to conclude that it would be beneficial to have a more definitive assessment of this issue. Therefore, we find that Atmos-KY. should seek a private-letter ruling from the IRS with the intent that such ruling be filed with the application in Atmos-KY.'s next general rate case.[4]

This request for a private letter ruling ("PLR") is being submitted pursuant to the Final Order.

[3] Final Order at pages 6-7.
[4] Final Order at page 7.

RULINGS REQUESTED[5]

Taxpayer respectfully requests the following rulings:

1. *Under the circumstances described above, the reduction of Taxpayer's rate base by the balance of its ADIT accounts 282 and 283 unreduced by its NOLC-related deferred tax account (a/c 190) balance would be inconsistent with (and, hence, violative of) the requirements of Code §168(i)(9) and Treasury Regulations §1.167(l)-1.*

2. *For purposes of Ruling 1 above, the use of a balance of Taxpayer's NOLC-related deferred tax account (a/c 190) that is less than the amount attributable to accelerated depreciation computed on a "last dollars deducted" basis would be inconsistent with (and, hence, violative of) the requirements of Code §168(i)(9) and Treasury Regulations §1.167(l)-1.*

STATEMENT OF LAW

Former Code §38(c)(1) provided that an investment tax credit ("ITC") is allowed only to the extent its use is not limited by the taxpayer's tax liability.

Code §168(f)(2) provides that MACRS depreciation does not apply to any public utility property if the taxpayer does not use a normalization method of accounting.

Code §168(i)(9) provides that, in order to use a normalization method of accounting, if a taxpayer claims a depreciation deduction that differs from its regulatory depreciation, the

[5] Taxpayer recognizes that the Normalization Rules apply only to the benefits of accelerated depreciation. With regard to a/c 283, none of the balance relates to accelerated depreciation and, hence, this portion of Taxpayer's ADIT balance is not subject to the normalization rules. With regard to a/c 282, some of the account balance relates to accelerated depreciation. Some relates to other items such as state taxes and repairs. Thus, some, but not all, of this balance will be subject to the Normalization Rules. With regard to a/c 190, only the portion of the account balance that is attributable to the federal NOLC produced by claiming accelerated depreciation is subject to the Normalization Rules. Henceforth in this ruling request, references to balances in a/c 282 and a/c 190 will denote the portion of those account balances that are subject to the Normalization Rules.

taxpayer must make an adjustment to a reserve to reflect the deferral of taxes resulting from such difference. It further provides that any procedure or adjustment that is used for tax expense, depreciation expense or the reserve for deferred taxes must be used with respect to the other two and with respect to rate base.

Treas. Reg. §1.46-6(g)(2) provides that the ITC normalization rules permit the ratable amortization only of ITC "allowed."

Treas. Reg. §1.167(l)-1(h)(1)(iii) provides that, if, in respect of any year, the use of other than regulatory depreciation for tax purposes results in an NOLC carryover (or an increase in an NOLC which would not have arisen had the taxpayer claimed only regulatory depreciation for tax purposes), then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director.

Treas. Reg. §1.167(l)-1(h)(6)(i) provides that a taxpayer does not use a normalization method of accounting if the reserve by which rate base is reduced exceeds the amount of such reserve used in determining the taxpayer's expense in computing cost of service in such ratemaking.

PLRs 7836038 (June 8, 1978) and 7836048 (June 9, 1978) both addressed the use by California regulators of the "average annual adjustment method" ("AAAM") for setting rates. In each of the rulings, the Service held that the AAAM violated the Normalization Rules because it flowed through a portion of the reserve for deferred taxes to customers.

PLR 8818040 (February 9, 1988) involved a taxpayer who generated NOLCs in 1985 and 1986 which it carried forward and used to offset taxable income in 1987. Accelerated depreciation claimed with respect to public utility property contributed to the NOLCs. The tax rate was 46% in both 1985 and 1986 and was 39.95% in 1987. The taxpayer recorded no deferred taxes applicable to the depreciation that produced the NOLCs in the years in which the deductions were claimed (1985 and 1986) but, instead, recorded the applicable deferred taxes in 1987 when the NOLCs were absorbed at the lower 39.95% tax rate in effect in that year. The Service held that this procedure complied with the Normalization Rules.

PLR 8903080 (October 26, 1988) addressed, *inter alia*, a situation in which the taxpayer generated an NOL which could be carried back to a year in which the tax rate was higher than the tax rate applicable to the year in which the NOL was generated. The Service ruled that the allocation of the benefit of the higher tax rate ratably to all book-tax timing differences, including accelerated depreciation, incurred in the NOL year complied with the Normalization Rules.

PLR 9309013 (December 1, 1992) involved a utility taxpayer who had made an election to treat its ITC pursuant to the requirements of former Code §46(f)(2). The taxpayer claimed ITC with respect to certain public utility property but was unable to use credit due to the limitation based on its tax liability of Code §38(c)(1). The unused ITC was carried forward. The Service ruled that the ITC normalization rules (of former Code §46(f)) would be violated if the

ITC was used to reduce cost of service in a period before it was used as an offset against Federal income tax.

In PLR 9336010 (June 7, 1993) the Service again addressed a situation in which the taxpayer generated an NOL which could be carried back to a year in which the tax rate was higher than the tax rate applicable to the year in which the NOL was generated. The question raised was the extent to which the NOL carryback was attributable to accelerated depreciation and, hence, gave rise to excess deferred taxes. The Service held that, if no particular items caused the NOL, then an appropriate methodology would be the pro rata allocation of the excess deferred taxes to all timing differences for the year of the NOL.

In PLR 201418024 (May 2, 2014), the Service addressed the implications under the Normalization Rules of the treatment of a utility taxpayer's NOLC. In setting rates, the utility's regulators reduced the utility's rate base by its ADIT balance. The utility had an NOLC-related DTA that was attributable to accelerated depreciation deductions. The utility argued that the Normalization Rules required that its DTA be factored into the ADIT computation for this purpose. The regulators asserted that their process for setting rates already recognized the effects of the utility's NOLCs insofar as it included "a provision for deferred taxes based on the entire difference between accelerated tax and regulatory depreciation, including situations in which a utility has an NOLC . . ." The Service concluded that, if the regulators took the effect of the NOLC into account when establishing the tax expense element of cost of service, as they

asserted they did, then the Normalization Rules did not require that the DTA to also be considered in the determination of rate base.

In PLRs 201436037, 201436038 (both September 5, 2014) and 201438003 (September 19, 2014) the Service addressed the treatment of NOLCs in ratemaking. In each of those rulings the Service concluded that (1) to the extent that the taxpayer's NOLC-related DTA is attributable to accelerated depreciation, it must reduce the ADIT balance by which rate base is reduced and (2) the NOLC is attributable to accelerated depreciation to the extent that the claiming of accelerated depreciation created or increased the NOLC in the taxable year (*i.e.*, a "last dollars deducted" computation).

DISCUSSION AND ANALYSIS

Requested Ruling #1.

As a result of Taxpayer's accumulated NOLCs, its ability to benefit from some of its accelerated depreciation tax deductions has been delayed until such time as the NOLCs can be used to offset future taxable income and thereby reduce a future tax liability. Treas. Reg. §1.167(l)-1(h)(1)(iii) is the only place in the normalization regulations in which an NOLC is mentioned. That subparagraph applies when a taxpayer produces an NOLC and claims depreciation deductions that exceed regulatory (*i.e.*, book) depreciation for the year. In such a

situation, the section provides that the tax deferral shall be taken into account for regulatory purposes in such time and manner as is satisfactory to the district director.[6]

This provision indicates, at the very least, that the Normalization Rules factor into the timing of tax benefit recognition where there is an NOLC. In other words, it identifies an NOLC situation as one that is distinctive under the Normalization Rules. The very existence of this language indicates that the regulatory treatment of an NOLC has normalization implications. The involvement of the district director would, of course, be unnecessary unless the timing and manner of benefit recognition was important to compliance with the Normalization Rules. So, while this provision may not prescribe a definitive answer regarding what the Normalization Rules actually require, it indicates that they are implicated when a utility has both an NOLC and accelerated depreciation in the same year.

PLR 8818040 specifically addressed the application of the Normalization Rules in the context of an NOLC. In that ruling, the Service described the circumstances of a utility taxpayer with an NOLC as follows:

> However, the taxpayer did not realize the entire tax benefit from the ACRS depreciation claimed in 1985 and 1986 because the depreciation resulted in a NOL carryover to 1987. Therefore, in order to reflect the tax benefit of the NOL carryover to 1987, the taxpayer reduced its deferred Federal income tax expense and liability for 1985 and 1986 for financial reporting purposes. The net effect of this accounting in 1985 and 1986 was to record no deferred taxes applicable to the amount of ACRS depreciation that produced no current tax savings but rather

[6] This regulation section employs a "last dollars deducted" measurement in order to determine whether the district director's discretion comes into play. That is, accelerated depreciation is deemed to be the last deduction claimed.

> caused or increased taxpayer's NOL carryover to 1987. The taxpayer only recorded deferred taxes applicable to ACRS when and to the extent that the use of ACRS produced an actual tax deferral.

The Service concluded that, where the utility produced NOLCs in years in which it claimed accelerated depreciation, its decision not to "book" deferred taxes in the years in which the deductions were claimed and its "booking" of deferred taxes in the year in which the NOLCs were eventually used was consistent with the Normalization Rules.[7] This PLR confirms that NOLCs must pass muster under the Normalization Rules.

Treas. Reg. §1.167(l)-1(h)(6)(i) is potentially much more directly relevant to Taxpayer's situation. This provision imposes a limitation on the extent to which a taxpayer can reduce its rate base by its ADIT reserve. The provision requires that any ADIT balance used to reduce rate base must have been reflected as deferred tax expense in computing cost of service. In other words, there is a necessary connection between deferred taxes in cost of service and the permissible ADIT balance by which rate base can be reduced. From an accounting as well as an economic perspective, such a connection clearly does exist. This provision of the regulations suggests that, as a condition of complying with the Normalization Rules, this connection must also exist in establishing rates.

---

[7] Note, however, that the issue in PLR 8818040 was not the limitation on the amount by which rate base can be reduced. It was the computation of the tax expense element of cost of service. Therefore, though the situation was similar to Taxpayer's, the Service's holding is not directly relevant to this ruling request. Moreover, in that ruling the Service held that the taxpayer's delay in the booking of its deferred taxes was consistent with the Normalization Rules - not that to do otherwise would not be.

The regulation itself offers no rationale for this rule. One can, however, surmise that it was intended to preclude the extraction of the benefits of accelerated depreciation by inflating an ADIT balance beyond the amount that is economically justified. In fact, this was the basis upon which the Service found the AAAM used by the regulators in California inconsistent with the Normalization Rules in PLRs 7836038 and 7836048. The "consistency rules" of Code §168(i)(9)(B) make (and were enacted to make) absolutely clear that identical ratemaking conventions must be applied to the computation of depreciation expense, tax expense, the ADIT reserve and rate base. In recognizing ADIT for purposes of computing rate base that has not been reflected in tax expense, two differing conventions are being applied and that contravenes the consistency rules.

The ITC normalization rules of former Code §46(f) address a situation possibly analogous to Taxpayer's. Under those rules, a taxpayer is not permitted to commence the amortization of its ITC until the credit is used to reduce its Federal income tax liability. See PLR 9309013. Thus, under this "other" branch of the normalization rules, utility taxpayers are prohibited from providing the benefit of a protected tax attribute (ITC) to ratepayers before they themselves receive the benefit. To do otherwise would violate the ITC normalization rules.

Because the "fronting" of a tax benefit in such a way diminishes the value of the benefit to the utility, the protection of the value of ITC to a utility taxpayer described above suggests a counterpart requirement in the case of accelerated depreciation. Providing ratepayers a benefit produced by accelerated depreciation before that deduction reduces a tax liability economically

diminishes the value of accelerated depreciation. That is what occurs where the effect of an NOLC is not considered in ratemaking. In fact, and counterintuitively, a utility subject to such ratemaking (that is, ratemaking that ignores the ADIT impact of the NOLC) would be better off not claiming accelerated depreciation to the extent it creates or increases an NOLC. If the utility did not claim these additional depreciation deductions, the tax it paid would not be impacted – it would still be zero. However, absent the NOLC, the utility would not reflect additional and offsetting amounts in a/c 282 and a/c 190. As a result, its rate base would not be reduced by the incremental balance in a/c 282. In short, its rate base would not be reduced by the tax benefit of tax deferrals that have not yet occurred.

A review of the accounting entries on page 5 of this request demonstrates the Normalization Rule problem with the failure to recognize an NOLC-related DTA in the computation of rate base. Where there is an NOLC, the combined accounting entries are as follows:

	DR.	CR.
Current tax expense (a/c 409 – income)	$0	
Taxes payable (a/c 236 – balance sheet)		$0
Deferred tax expense (a/c 410 – income)	$350	
Deferred tax assets (a/c 190 – balance sheet)	$525	
Accumulated deferred taxes (a/c 282 – balance sheet)		$875

The table indicates that, in the example, the deferred tax expense included in cost of service is $350. If the DTA (a/c 190) is ignored for purposes of determining the quantity of ADIT by which to offset rate base, that offset amount would be $875. Consequently, the rate base offset ($875) would exceed the deferred tax expense included in cost of service ($350), a situation that, on its face, conflicts with the Normalization Rule requirement of consistency.

Treas. Reg. §1.167(l)-1(h)(2) provides that no specific bookkeeping is necessary to record an ADIT reserve required by the Normalization Rules so long as the amount of the reserve is identifiable. There is no reference to a single account. The strong implication is that all relevant accounts must be included in its computation. In terms of the limitation imposed by Treas. Reg. §1.167(l)-1(h)(1)(iii), this means that the ADIT reserve subject to the limitation is not restricted to Taxpayer's a/c 282 balance only. The two accounts (a/c 282 and a/c 190) together constitute the ADIT reserve for this purpose. Alternatively, the balance in a/c 282 reflects an amount that exceeds the tax deferred by virtue of claiming accelerated depreciation. In computing the limitation on the amount by which rate base can be reduced, the ADIT balance must be adjusted to conform to the requirements of the Normalization Rules – that is, it must be reduced by an amount equal to the balance in a/c 190.

More directly on point was the Service's recent holding in PLR 201418024. In that ruling, the Service held that the Normalization Rules required that the utility's NOLC-related DTA be "taken into account" by the utility's regulators in establishing rates. The way in which the regulators asserted that they "took it into account" was by imposing on customers a deferred

tax charge on the entire difference between book and tax depreciation whether or not the deduction created an NOLC. Under those circumstances, the Service ruled that the DTA did not have to be included in the ADIT calculation because it had already been "taken into account" in computing tax expense. The type of ratemaking for the DTA claimed by the regulators in PLR 201418024 is not practiced (or even claimed to be practiced) by the regulators in Kentucky. In Taxpayer's context, if the NOLC-related DTA is not included in the calculation of rate base, then it is not "taken into account" at all, a consequence of which is that the treatment will be inconsistent with the Normalization Rules.

And even more recently, the Service addressed exactly this issue in PLRs 201436037, 201436038 and 201438003. In each of these rulings the Service ruled that, to the extent that the taxpayer's NOLC-related DTA was attributable to accelerated depreciation, it must be reflected in the computation of the ADIT balance by which rate base is reduced.

Requested Ruling #2.

By design, the Normalization Rules operate to effectively limit the discretion that regulators have with regard to the treatment of the benefits of accelerated depreciation and investment tax credits. As indicated above, the normalization restrictions only apply to the extent that an NOLC is attributable to accelerated depreciation. Thus, a methodology for determining the amount of an NOLC that is attributable to accelerated depreciation will also determine the extent to which regulators do or do not have discretion with regard to the treatment

of that NOLC. This is, obviously, of critical importance to all parties to Taxpayer's rate proceedings.

Treas. Reg. §1.167(l)-1(h)(1)(iii) appears to be the only authority that addresses attribution for purposes of the Normalization Rules. The structure of this provision bears close examination. The first sentence sets out a general rule that clearly requires a "last dollars deducted" measurement procedure for determining the tax deferred by virtue of claiming accelerated depreciation. Under this method, an NOLC is attributable to accelerated depreciation to the extent of the lesser of (1) the accelerated depreciation claimed or (2) the amount of the NOLC. In effect, all deductions other than accelerated depreciation are offset against available taxable income prior to considering accelerated depreciation. The second sentence of the regulation provides another general rule – this one a timing rule for "taking into account" the tax deferred and measured pursuant to the first sentence. The third sentence then prescribes a different rule where there is an NOLC. The question is whether this third sentence is intended to prescribe a different rule for the timing of recognition of the tax deferred or, alternatively, for the way in which the tax deferred is measured – or, perhaps, for both. All that can be said is that this sentence specifies no alternative measurement procedure. Further, it fails to describe why or under what circumstances the general rule's "last dollars deducted" measurement procedure would be inappropriate.

In determining the portion of its NOLC (and, hence, its a/c 190 balance) that is attributable to accelerated depreciation subject to the Normalization Rules, Taxpayer presumed

the "last dollars deducted" measurement methodology described in Treas. Reg. §1.167(l)-1(h)(1)(iii). Note that, for purposes of attributing excess deferred taxes to the items of deduction comprising an NOL carryback, the Service has twice ruled that the ratable allocation of such excess to all of the book-tax timing differences occurring in the NOL year is permissible under the Normalization Rules. *See* PLRs 8903080 and 9336010. Notwithstanding these PLRs, since Taxpayer has an NOLC and not an NOL carryback, it has presumed the "last dollars deducted" technique described in the regulations rather than the ratable allocation approach described in the two PLRs. In all cases, the "last dollars deducted" measurement methodology will attribute a larger amount of an NOLC to accelerated depreciation than would a "ratable allocation" approach. Thus, Requested Ruling #2 asks the Service to rule that the use of any method other than the "last dollars deducted" method would be inconsistent with the Normalization Rules.

The one certain aspect of Treas. Reg. §1.167(l)-1(h)(1)(iii) is that the Service has discretion in this area. One of the factors that should be relevant to the Service's determination as to the appropriate allocation method is the relationship between the necessity to allocate the NOL and the Normalization Rules. The fundamental question is whether the NOL allocation methodology represents an element of the Normalization Rules or, alternatively, is external to them. If the NOL allocation process is itself an element of those rules, then it shares the specific Congressional purpose with those rules and should be viewed as a tool for accomplishing that purpose. Since the specific purpose of the Normalization Rules is to preserve the benefits of accelerated depreciation deductions to utilities, an allocation procedure that maximizes the

preservation of those benefits would further that Congressional purpose. Further, any procedure that does not maximize the preservation of those benefits would not further the purpose. By contrast, if the NOL allocation process is external to the Normalization Rules, then it does not share that Congressional purpose. If that were the case, the NOL allocation should take place under general tax principles and any portion attributed to accelerated depreciation under that allocation should then be subject to the protective provisions of the Normalization Rules.

The necessity to allocate an NOL to accelerated depreciation is occasioned by the Normalization Rules and only those rules. Taxpayer is aware of no other reason under the tax law to perform this allocation. Thus, "but for" the Normalization Rules, this allocation would not be necessary. Therefore, the allocation process appears to be an element of those rules. Further, Taxpayer is not aware of any general tax principles governing the attribution of an NOL to a specific deduction which could be used to determine the amount to which the Normalization Rules apply (though there are a number of statutory attribution directives applicable to specific deductions which will be identified and described below).

There appear to be three main options available to the Service: it can conclude that the Normalization Rules accommodate any allocation methodology, that they do not require any single methodology but do impose a standard of some type or that they require a single, specified methodology.

Concluding that the Normalization Rules do not require any particular allocation methodology would be tantamount to a determination that the Normalization Rules do not apply

to NOLCs. As a practical matter, the only limit this approach imposes would be in a situation where a taxpayer claims accelerated depreciation deductions in excess of its taxable revenues. Only then would at least some portion of the NOLC ***have*** to be attributed to accelerated depreciation. In all other cases, the NOLC could be attributed to other deductions and the Normalization Rules rendered inapplicable. Such a result would seem inconsistent with the Service's conclusion that the Normalization Rules do, in fact, apply to NOLCs as was indicated in PLRs 8903080 and 9336010 (which concluded that there was not unfettered discretion in allocating an NOL for purposes of the normalization rules), PLR 8818040 and, most especially, PLR 201418024.

Concluding that, while the Normalization Rules do impose a limitation on the allocation method used, more than one method may be permissible would provide regulatory discretion – though not unfettered discretion. If this were the case, there would need to be some very specific parameters provided to enable companies and regulators to distinguish between those methods that are permissible and those that are not. A failure to provide such parameters would create a "We can't define it but we know it when we see it" situation. This would almost ensure that every allocation methodology proposed by a utility, its regulators or rate case intervenors would need to be vetted with the National Office before being implemented. A flood of PLR requests would likely result. The uncertainty inherent in this approach renders it a very undesirable solution and, ultimately, the IRS will still have to address the very same issue in a piecemeal fashion.

The adoption of a single, mandated allocation methodology should, depending on the specific method selected, avoid uncertainty and inconsistency. There appear to be three main allocation approaches available to the Service – "last dollars deducted", "first dollars deducted"[8] or some type of ratable allocation. Both the "first dollars deducted" and the "last dollars deducted" methodologies are simple, specific, transparent and would produce uniformity among taxpayers. Nothing other than "book" and tax depreciation would need to be quantified so that these methodologies would operate independently of financial accounting concepts and rules (aside from the concept of "book" depreciation – a well understood concept). These two methodologies would be difficult to manipulate so that it is highly likely that all taxpayers would be similarly treated. Finally, because the bases of computation ("book" and tax depreciation) used in these methodologies are so well understood, they would be resistant to controversy.

By contrast, a ratable allocation methodology inherently involves uncertainty – starting with the question of "ratable with regard to what?" The two PLRs that applied a ratable allocation methodology (PLRs 8903080 and 9336010) used all timing differences as the basis for allocation. An allocation on this basis is subject to uncertainty, variability and is based on questionable logic. Among the issues are:

1. There is no logical basis on which to distinguish between timing and permanent differences insofar as both have the same effect on taxable income;

[8] "First dollars deducted" refers to the method that treats accelerated depreciation deductions as being the first deductions applied against taxable income before considering any other deductions.

2. Since there are both timing differences that increase (unfavorable) as well as decrease (favorable) taxable income, an allocation that is based on all timing differences requires both positive and negative allocations of an NOL – something that doesn't make inherent sense;

3. Even if the allocation is based only on favorable timing difference, there are favorable timing differences that relate to income items rather than deductions. An allocation to such a favorable timing item would be questionable since the purpose of the allocation is to distinguish between accelerated depreciation and other deductions;

4. If the allocation is based only on favorable timing differences or even only on favorable timing differences produced by deductions, the way in which a taxpayer nets or fails to net related favorable and unfavorable timing items can have a material impact on the result of the allocation. In other words, the allocation can vary depending entirely on presentation – not economics – and different companies have different practices in this regard; and

5. If the financial or regulatory accounting rules change for an item, then the NOL allocation would change even though there is no change in the tax law.

Though an allocation based purely on tax deductions (rather than book/tax timing differences) would de-link completely from financial reporting concepts, it would come with its own set of issues. Among these are:

1. For a utility that generates electricity, many costs that would otherwise be deductions are, for tax purposes, reflected in cost of goods sold which, as a technical matter, is not a deduction but an offset against revenues in deriving gross income;[9] and
2. The Normalization Rules do not actually apply to a tax deduction but to a portion of a tax deduction - the excess of accelerated over regulatory depreciation. Thus, allocating an NOL between deductions will not, itself, produce an amount of the NOL that is subject to the Normalization Rules.

In short, a ratable allocation methodology is questionable from a simplicity, administrability and uniformity perspective.

Returning to an evaluation of the two simpler options, "first dollars deducted" and "last dollars deducted", the choice between the two is relatively stark.

The "first dollars deducted" methodology minimizes the portion of any year's NOLC that is attributed to accelerated depreciation. In fact, using that methodology, the only time the normalization rules would impact the treatment of an NOLC is where a company's accelerated depreciation exceeds its taxable revenue for the year. This approach would clearly be inconsistent with the legislative intent of protecting the benefits of accelerated depreciation which underlies the Normalization Rules. Further, there is no instance of which Taxpayer is

[9] Though Taxpayer is a gas utility, presumably whatever rule is applicable to it would be equally applicable to such a utility.

aware where a "first dollars deducted" approach is or has been used in a statute, regulation, ruling or other authority to determine the portion of an NOL attributable to any particular deduction.

By contrast, the "last dollars deducted" methodology maximizes the portion of an NOLC that is attributed to accelerated depreciation and, thus, this methodology appears most aligned with the purpose of the Normalization Rules. The tax benefits of accelerated depreciation will be protected to the extent accelerated depreciation was claimed. In fact, it is not unusual for the Code to employ a "last dollars deducted" approach to allocating an NOL to a specific tax deduction both where the deduction has been identified for especially beneficial treatment and, in one instance, where it has been identified for especially unfavorable treatment. The following Code provisions all determine the portion of an NOL that is attributable to a specified deduction in this way:

1. Code §1212(a)(1)(C) – this section provides that the carryforward period for a capital loss carryover that is attributable to a foreign expropriation loss is 10 years instead of the normal 5 years;
2. Code §172(b)(1)(C) – this section provides that the carryback period for a specified liability loss is 10 years rather than the normal 2 years;
3. Code §172(b)(1)(D) – this section provides that the carryback period for the portion of an NOL that is attributable to the deduction for bad debts by a commercial bank is 10 years rather than the normal 2 years;

4. Code §172(b)(1)(E) – this section provides that a corporate equity reduction interest loss may not be carried back to the year preceding the year is which the corporate equity reduction transaction occurs;
5. Code §172(b)(1)(G) – this section provides that the carryback period for a farming loss is 5 years rather than the normal 2 years; and
6. Code §172(b)(1)(J) – this section provides that the carryback period for a qualified disaster loss is 5 years rather than the normal 2 years.

The common feature in all of these provisions is that, in each case, the statutory allocation methodology maximizes the NOL attributable to the identified deduction. Taxpayer has not encountered a statutory provision that associates an NOL with specific deductions in any other way.

If, in fact, the NOL allocation is an element of the Normalization Rules, a "last dollars deducted" approach would be consistent with the policy underlying those rules. Further, the frequency - and uniformity - of Congress's use of a "last dollars deducted" approach whenever an NOL is to be allocated to a specific deduction strongly supports the propriety of that approach in a situation in which Congress has singled out accelerated depreciation for special treatment under the tax law. These considerations, coupled with the many positive administrative attributes of such an approach, support its application in this situation.

Finally, the Service addressed this very issue in PLRs 201436037, 201436038 and 201438003. In each of these rulings the Service ruled that, in determining the portion of an

NOLC that is attributable to accelerated depreciation, any method other than the "with and without" method (the same as the "last dollars deducted" method) would be inconsistent with the Normalization Rules.

CONCLUSION

For the reasons set forth above, we respectfully request that the Service issue the rulings requested.

PROCEDURAL MATTERS

A. Statements required by Rev. Proc. 2014-1:

1. Section 7.01(4) –To the best of the knowledge of both Taxpayer and Taxpayer's representative, the issue that is the subject of this requested letter ruling is not addressed in any return of Taxpayer, a related taxpayer within the meaning of §267, or of a member of an affiliated group of which Taxpayer is also a member within the meaning of §1504 that is currently or was previously under examination, before Appeals, or before a Federal court.

2. Section 7.01(5)(a) – Taxpayer, a related party taxpayer within the meaning of §267, or a member of an affiliated group of which Taxpayer is also a member has not, to the best of the knowledge of both Taxpayer and Taxpayer's representative, received a ruling on the issue that is the subject of this requested letter ruling.

3. Section 7.01(5)(b) - To the best of the knowledge of Taxpayer and Taxpayer's representative, neither Taxpayer, a related taxpayer, a predecessor, nor any representatives

previously submitted a request involving the same or a similar issue to the Service but with respect to which no letter ruling or determination letter was issued.

4. Section 7.01(5)(c) - To the best of the knowledge of Taxpayer and Taxpayer's representative, neither Taxpayer, a related taxpayer, nor a predecessor, previously submitted a request (including an application for change in method of accounting) involving the same or a similar issue that is currently pending with the Service.

5. Section 7.01(5)(d) – To the best of the knowledge of Taxpayer and Taxpayer's representative, neither Taxpayer nor a related taxpayer are presently submitting additional requests involving the same or a similar issue.

6. Section 7.01(8) - The law in connection with this request is uncertain and the issue is not adequately addressed by relevant authorities.

7. Section 7.01(9) - Taxpayer has included all supportive as well as all contrary authorities of which it is aware.

8. Section 7.01(10) - Taxpayer is unaware of any pending legislation that may affect the proposed transaction.

9. Section 7.02(5) - Taxpayer hereby requests that a copy of the ruling and any written requests for additional information be sent by facsimile transmission (in addition to being mailed) and hereby waives any disclosure violation resulting from such facsimile transmission. Please fax the ruling and any written requests to James I. Warren at (202) 626-5801.

10. Section 7.02(6) - Taxpayer respectfully requests a conference on the issues involved in this ruling request in the event the Service reaches a tentatively adverse conclusion.

11. Taxpayer will permit the KPSC to participate in any Associate office conference concerning this ruling request. Taxpayer has provided the KPSC with a copy of this ruling request prior to its being filed.

B. Administrative

1. The deletion statement and checklist required by Rev. Proc. 2014-1 are enclosed.

2. The required user fee of $19,000 is enclosed.

3. A Form 2848 Power of Attorney granting Taxpayer's representative the right to represent Taxpayer is enclosed.

If you have any questions or need additional information regarding this ruling request, pursuant to the enclosed Power of Attorney, please contact James I. Warren at (202) 626-5959.

Respectfully submitted,

James I. Warren
Miller & Chevalier Chartered
Attorney for Atmos Energy Corporation

PENALTIES OF PERJURY STATEMENT

Atmos Energy Corporation

Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and, to the best of my knowledge and belief, the request contains all the relevant facts relating to the request, and such facts are true, correct, and complete.

ATMOS ENERGY CORPORATION

BY: Pace McDonald

Printed Name: Pace McDonald

DATE: 1/7/15

Attachment

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF ATMOS ENERGY CORPORATION FOR AN ADJUSTMENT OF RATES AND TARIFF MODIFICATIONS	)))	CASE NO. 2013-00148

TABLE OF CONTENTS

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF ATMOS ENERGY CORPORATION FOR AN ADJUSTMENT OF RATES AND TARIFF MODIFICATIONS	)))	CASE NO. 2013-00148

ORDER

Atmos Energy Corporation ("Atmos"), a gas distribution company operating in eight states, serves roughly 3.1 million customers. Its Kentucky/Mid-States division, one of six operating divisions, provides natural gas service in Kentucky, Tennessee and Virginia. Atmos's Kentucky unit ("Atmos-Ky.") serves approximately 173,000 customers in 38 central and western counties in Kentucky. The most recent adjustment of its Kentucky operating unit's base rates was in May 2010 in Case No. 2009-00354.[1]

BACKGROUND

On May 13, 2013, Atmos-Ky. submitted its application based on a forecasted test period ending November 30, 2014, seeking an increase in revenues of $13,367,575, or 8.6 percent, with a proposed effective date of June 13, 2013.

A review of the application revealed that it did not meet the minimum filing requirements of 807 KAR 5:001, Sections 4 and 16, and a notice of filing deficiencies was issued. Atmos-Ky. filed information on May 30, 2013, and June 3, 2013, to cure

[1] Case No. 2009-00354, *Application of Atmos Energy Corporation for an Adjustment of Rates* (Ky. PSC May 28, 2010).

the noted filing deficiencies. Our June 24, 2013 Order found that this information satisfied all of the filing requirements cited in our deficiency notice except the requirement for Atmos-Ky. to post its application and other documents on its website. The Commission found that this deficiency would remain until Atmos-Ky. provided proof that it had posted its application and other documents filed with its application on its website. Atmos-Ky. responded to that Order that same day by providing a copy of the page that had been posted on its website listing the documents. A notice that Atmos-Ky.'s deficiencies had been cured was issued June 26, 2013, stating that that the application met the minimum filing requirements as of June 24, 2013. Based on a June 24, 2013 filing date, the earliest possible date Atmos-Ky.'s proposed rates could become effective was July 24, 2013.

The Commission found that an investigation would be necessary to determine the reasonableness of Atmos-Ky.'s proposed rates and suspended them for six months, from July 24, 2013, up to and including January 23, 2014, pursuant to KRS 278.190(2). The suspension Order included a procedural schedule which provided for discovery on the application, intervenor testimony, discovery on any intervenor testimony, rebuttal testimony by Atmos-Ky., a public hearing, and an opportunity to file post-hearing briefs.

Petitions to intervene were filed by the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("AG"), Kentucky Industrial Utility Customers, Inc. ("KIUC"), and Stand Energy Corporation ("Stand").[2] The AG was granted full intervention and Stand was granted full intervention, limited to participation on the issues of Atmos-Ky.'s transportation threshold levels and any matters related

[2] KIUC later withdrew its petition to intervene.

thereto. Discovery was conducted on Atmos-Ky.'s application by both the AG and the Commission Staff ("Staff"). The AG filed testimony on which discovery was conducted by both Atmos-Ky. and Staff. Atmos-Ky. filed rebuttal testimony and the AG filed supplemental testimony in response to which Atmos-Ky. filed surrebuttal testimony. Stand filed no testimony.

Pursuant to KRS 278.190(2), Atmos-Ky. gave notice on January 22, 2014, of its intent to place its proposed rates in effect for service rendered on and after January 24, 2014. In our January 28, 2014 Order, we acknowledged that Atmos-Ky. had complied with the statutory provisions for placing its proposed rates in effect. That Order required that Atmos-Ky. maintain its records so that, in the event a refund were to be required, the amount of refunds and the customers to whom the refunds should be applied could be determined.

The Commission held an evidentiary hearing on the proposed rate adjustment on December 3, 2013 and January 23, 2014, at its offices in Frankfort, Kentucky. Post-hearing briefs were filed by Atmos-Ky., the AG, and Stand. All information requested at the formal hearing has been filed and the case now stands submitted for a decision. As discussed more thoroughly throughout this Order, the Commission is granting Atmos-Ky. a base-rate increase of $8,550,134, which is roughly 64 percent of what it requested and which represents an increase in total revenues of approximately 5.5 percent.

TEST PERIOD

Atmos-Ky. proposed the 12 months ending November 30, 2014, as its forecasted test period to determine the reasonableness of its proposed rates. While the AG did not object to the proposed test period or suggest an alternative test period, he criticized

Atmos-Ky.'s development of certain items contained in its proposed test period. The AG raised concerns with Atmos-Ky.'s forecasted filing regarding its lack of documentation, methodology, and specific impacts on costs.[3] The AG stated that he did not agree with using a forecasted test period, but that Atmos-Ky. did not respond adequately to certain data requests he propounded to elicit information that would have permitted a more thorough review of the data supporting the forecasted test period.[4]

Atmos-Ky. stated that its development of a forecasted test period begins with its budget, which it prepares annually for its October 1 to September 30 fiscal year. It described the numerous approvals to which its budgets are subjected, including the final review by the Atmos Board of Directors. Atmos-Ky. noted that, along with its Kentucky operations, Atmos maintains a Division General Office ("DGO") that manages utility operations in the states, including Kentucky, which make up the Kentucky/Mid-States division. It further noted that Atmos has a Shared Services Unit ("SSU") which provides support services such as accounting, billing, tax, call center, collections, etc., to the various operating divisions. Atmos-Ky. stated that separate budgets are developed each year at the Kentucky, DGO, and SSU levels.

The Commission finds Atmos-Ky.'s forecasted test period to be reasonable and consistent with the provisions of KRS 278.192 and Kentucky Administrative Regulation

[3] Direct Testimony of Bion C. Ostrander ("Ostrander Testimony") at 6.

[4] *Id.* at 7, 13, and 14.

5:001, Section 16 (6), (7), and (8). Therefore, we will accept the forecasted test period as proposed by Atmos-Ky. for use in this proceeding.[5]

VALUATION

Rate Base

Atmos-Ky. proposed a net investment rate base for its forecasted test period of $252,914,292 based on the 13-month average for that period.

The AG proposed to reduce Atmos-Ky.'s rate base to eliminate Net Operating Loss Carry-forwards ("NOLC") resulting from the losses reported by Atmos's regulated operations for tax purposes.[6] The AG stated that while he had no concerns with typical accumulated deferred income taxes ("ADIT") used to reduce rate base, an NOLC debit is an offset to the typical credit balance in ADIT, causing an increase in rate base.[7]

The AG opined that removing the NOLC from rate base would not cause a tax normalization violation.[8] In support of his recommendation, the AG cited a recent case before the West Virginia Commission in which Mountaineer Gas's proposal to include a NOLC in its rate base was denied.[9] If there was substantive disagreement by Atmos-

[5] Contrary to his contentions, we find that the AG had adequate opportunity to conduct discovery for the purpose of analyzing the proposed test period and components thereof. The Commission notes that the use of a forecasted test period is provided for in 807 KAR 5:001, Section 16. We also note that the criticism by AG witness Ostrander to the use of a forecasted test period, as he has done in this case and the two recent rate cases of Big Rivers Electric Corporation, is not supported by law or regulation. The AG did not file any motions regarding discovery disputes until his motion on Nov. 21, 2013 requesting that the Dec. 3, 2013 Hearing be postponed, which the Commissioner granted.

[6] The amount the AG removed from rate base was $22,221,329, which was an estimate. Atmos-Ky. clarified that that the NOLC amount included in its rate base was $20,125,550.

[7] Ostrander Testimony at 49.

[8] *Id.* at 51.

[9] *Id.* at 55.

Ky. on the NOLC rate base issue, the AG recommended that Atmos-Ky. obtain a private-letter ruling from the Internal Revenue Service ("IRS") to resolve the issue.[10]

Atmos-Ky. claimed that removing the NOLC from rate base would result in a tax normalization violation of the Internal Revenue Code.[11] It stated that a violation would cause it to lose accelerated depreciation, bonus depreciation, and other tax benefits. Atmos-Ky. also claimed that removing NOLCs from its rate base is inappropriate and inconsistent with sound ratemaking principles, and that inclusion of NOLCs in rate base has been accepted by many commissions, including these in all other states in which Atmos's distribution companies operate.[12] It noted that the Mountaineer Gas case cited by the AG is the only instance in which a utility regulator ruled that NOLC should not be included in rate base.[13] Atmos-Ky. stated that if the Commission determined that its NOLC should remain in rate base, there was no need to involve the IRS with a private letter ruling request. However, if the Commission requires that it seek such a ruling, Atmos-Ky. asks to be allowed to create a regulatory asset to defer the costs related to such a request and seek recovery of them in its next general rate case.[14]

The Commission is not persuaded by the AG's argument. While there is some ambiguity in the Treasury regulations cited by the AG and Atmos-Ky. on the subject of NOLCs, we are unable to agree with the AG that a tax normalization violation would not

---

[10] *Id.* at 57-58.

[11] Rebuttal Testimony of Pace McDonald at 4.

[12] *Id.* at 16-19 and 22.

[13] *Id.* at 21.

[14] Atmos-Ky.'s post-hearing brief at 17.

result from a decision to remove NOLCs from Atmos-Ky.'s rate base. The AG has not made a compelling argument for why, from a ratemaking perspective, it would be reasonable to adopt his recommendation.

Although we are rejecting the AG's proposal, the aforementioned ambiguity in the governing regulations and the significantly different interpretations of those regulations by the AG and Atmos-Ky. cause the Commission to conclude that it would be beneficial to have a more definitive assessment of this issue.[15] Therefore, we find that Atmos-Ky. should seek a private-letter ruling from the IRS with the intent that such ruling be filed with the application in Atmos-Ky.'s next general rate case. We also find that Atmos-Ky. should be permitted to create a regulatory asset to defer the costs related to its private-ruling request in order to seek their recovery in its next general rate case.

Having rejected the AG's proposal to exclude the NOLC, the Commission has determined that Atmos's net investment rate base is $252,737,721 as shown below. Cash working capital has been reduced to reflect the adjustments to operation and maintenance ("O&M") expenses discussed later in this Order.

Utility Plant in Service	$ 445,835,433
Construction Work In Progress	8,541,792
Total Utility Plant	$ 454,377,225
LESS:	
Accumulated Depreciation	$ 166,889,761
Net Utility Plant	$ 287,487,464
ADD:	
Gas Stored Underground	$ 9,415,216
Materials and Supplies	58,851
Prepayments	1,254,362
Working Capital	3,160,640

[15] It is possible that the NOLC issue may be at issue in future Atmos-Ky. rate cases.

Subtotal	$	13,889,069
DEDUCT:		
Customers Advances for Construction	$	2,745,576
Accumulated Deferred Income Taxes And Investment Tax Credits		45,893,236
Subtotal	$	48,638,812
NET INVESTMENT RATE BASE	$	252,737,721

CAPITAL STRUCTURE

As a division of Atmos, Atmos-Ky. does not have a stand-alone capital structure. Using Atmos's capital balances, Atmos-Ky. proposed a test-period capital structure consisting of 51.83 percent common equity and 48.17 percent long-term debt. It also presented a second capital structure for informational purposes consisting of 49.16 percent common equity, 45.68 percent long-term debt, and 5.16 percent short-term debt.[16] Atmos-Ky. stated that the capital structure containing no short-term debt was appropriate for determining its revenue requirement in that Atmos-Ky. did not use short-term debt to finance the long-lived assets in its rate base.[17]

The Commission is not persuaded by Atmos-Ky.'s reasoning for not reflecting short-term debt in its capital structure. To the extent there is a connection between long-lived assets and long-term forms of capital, the Commission has recognized that a utility's rate base includes items other than long-lived plant assets that may be financed

[16] The second capital structure reflected a short-term debt component based on the average short-term debt balance of Atmos for the 12 months ended March 31, 2013.

[17] Cross-examination of Gregory K. Waller, January 23, 2014 Hearing at 16:55:50 – 16:56:04.

with short-term debt.[18] Furthermore, while it is the intent of utilities, from a planning perspective, to finance long-lived assets with long-term forms of capital, from a practical perspective the Commission has long held the position that capital cannot be assigned directly to a particular state, jurisdiction or specific asset.[19]

In its last litigated case, Atmos-Ky., formerly Western Kentucky Gas, ("Western"), proposed a capital structure that contained no short-term debt. However, finding that "Western uses significant amounts of short-term debt on an ongoing basis..." the Commission approved a capital structure containing 8.47 percent short-term debt.[20] In the time since that case, the Commission has issued decisions in 14 litigated rate cases involving investor-owned gas or electric utilities, or combination gas and electric utilities. In 13 of those cases, the Commission authorized a capital structure containing a short-term debt component. The one exception occurred when the utility had used its short-term debt to reacquire bonds during the historical test period used in that case.[21]

Having considered Atmos-Ky.'s argument and the historical practice employed in Kentucky rate cases for more than two decades, we find that the appropriate capital structure in this matter should include a short-term debt component. Accordingly, based on the record evidence, the Commission will approve for ratemaking purposes a capital

---

[18] Case No. 8738, *An Adjustment of Rates of Columbia Gas of Kentucky* (Ky. PSC July 5, 1983) at 21.

[19] Case No. 9678, *An Adjustment of Rates of General Telephone Company of the South* (Ky. PSC Apr. 16, 1987) at 9. Case No. 10117, *Adjustment of Rates of GTE South, Inc.* (Ky. PSC Sept. 1, 1988) at 11.

[20] Case No. 90-013, *Rate Adjustment of Western Kentucky Gas Company* (Ky. PSC Sept. 13, 1990) at 19.

[21] Case No. 2009-00549, *Application of Louisville Gas and Electric Company for an Adjustment of Electric and Gas Base Rates* (Ky. PSC July 30, 2010).

structure that contains 49.16 percent common equity, 45.68 percent long-term debt, and 5.16 percent short-term debt.

REVENUES AND EXPENSES

Atmos-Ky. developed an operating statement for its forecasted test period based on its budgets for fiscal years 2013 and 2014. As required by 807 KAR 5:001, Section 16(6)(a), the financial data for the forecasted test period was presented by Atmos-Ky. in the form of pro forma adjustments to its base period, the 12 months ending July 31, 2013.[22] Based on the assumptions built into its budgets, Atmos-Ky. calculated its test-year operating revenues and Operations and Maintenance ("O&M") expenses to be $155,374,969 and $141,914,890, respectively.[23] These test-year operating revenues included gas cost revenues of $90,265,243, based on Atmos-Ky.'s estimate of gas cost to be recovered through its Gas Cost Adjustment mechanism.[24]

Based on the adjusted revenues and O&M expenses stated above, Atmos-Ky.'s test-period operating income was $13,460,079, which, based on its proposed rate base, results in a 5.32 percent overall rate of return. Based on a proposed return on equity ("ROE") of 10.7 percent, Atmos-Ky. determined that it required a revenue increase of $13,367,575, which would produce an overall return on rate base of 8.53 percent.

The AG, based on a number of proposed adjustments to Atmos-Ky.'s test-period results, and a 7.63 percent overall return on rate base, calculated Atmos-Ky.'s operating

---

[22] Application, Vol. 9 of 9, Schedules D.1 and D.2.

[23] *Id.* Schedule C-1.

[24] In response to Item 28 of Staff's Second Request for Information (Staff's Second Request"), Atmos-Ky. updated its estimate of gas cost revenues for the test period to $111,008,901.

revenue to be $16,831,319 and recommended an increase in revenues of $1,215,895.[25] The AG later revised his recommendation, and increased the amount of the revenue increase to $2,736,433.[26]

The Commission will accept most components of Atmos-Ky.'s test period and many of its proposed adjustments. We will also accept some of the AG's proposed adjustments. A discussion of the individual adjustments accepted, modified or rejected by the Commission and the impact of those adjustments on Atmos-Ky.'s revenue requirement follows.[27]

Revenue Normalization

In normalizing test period revenues, Atmos-Ky. increased its firm sales volumes by 2,189,876 Mcf to reflect its adjustment for weather normalization based on the National Oceanic and Atmospheric Administration's ("NOAA") normal Heating Degree Day ("HDD") data for the 30-year period ending 2010.[28] It further adjusted its firm sales volumes by (427,287) Mcf to reflect changes in consumption due to a long-standing trend in conservation and efficiency by its residential, commercial, and public authority customer classes. For other classes, Atmos-Ky. adjusted customer numbers and sales and transportation volumes for known and measurable changes in service contracts and

[25] Ostrander Testimony, Exhibit BCO-2, Schedule A-1.

[26] Supplemental and Corrected Direct Testimony of Bion C. Ostrander ("Ostrander Corrected Testimony") at 2.

[27] Two AG adjustments to which Atmos-Ky. agreed on rebuttal were: a reduction in bad-debt expense of $25,048 and removal of duplicate billing systems' maintenance fees in the amount of $51,262.

[28] Direct Testimony of Mark A. Martin ("Martin Testimony"), Exhibit MAM-4.

customer usage, resulting in a decrease in interruptible sales volumes of approximately 330,000 Mcf and an increase in transportation volumes of approximately 500,000 Mcf.[29]

The Commission finds Atmos-Ky.'s adjustments to be reasonable and accepts its normalized base-rate revenues. With regard to weather normalization methodology to be used in future rate proceedings, the Commission finds that Atmos-Ky. should use the most recent temperature data available. In response to a Staff request for information, Atmos-Ky. stated its belief that there is a benefit to using NOAA's published 30-year temperature normal product, because NOAA thoroughly analyzes the data and smooths the average daily HDD to produce daily normals.[30] Because the Commission is aware that this is the case, and with the data's having been published in July 2011, it is reasonable to use the 30 years ended 2010 to weather normalize sales volumes and revenues in this case. The Commission does not believe it would be reasonable to continue to use the same 30-year period to weather normalize sales volumes and revenues in future rate proceedings brought prior to NOAA's next published 30-year temperature-normal product, and therefore, we will require that a more current time period be used. The Commission will also require that Atmos-Ky. file a comparison of weather normalization methodologies using time periods including, but not limited to, 20, 25, and 30 years in length. Along with its comparison of results, Atmos-Ky. should include support for the time period it proposes to use to normalize revenues, including the superiority of the chosen method in terms of its predictive value for future temperatures.

[29] *Id.*, Exhibit MAM-3.

[30] Response to Staff's Second Request, Item 26.

Payroll and Benefits

Atmos-Ky.'s test period includes combined direct payroll and benefits expense of $8,865,683. It also includes allocated DGO and SSU payroll and benefits expenses of $7,570,803. The AG compared these amounts to the actual fiscal year 2012 payroll and benefits expenses incurred by Atmos-Ky. and the amounts allocated to it by DGO and SSU for that period and recommended an adjustment to reduce test-period payroll and benefits expenses by one-half of the difference, or $1,212,712.[31] The AG claimed that the levels proposed by Atmos-Ky. represented significant and unusual increases for which Atmos-Ky. had failed to meet a reasonable burden of proof.[32]

Atmos-Ky. asserted that the AG's adjustment ignores the guidelines set forth in 807 KAR 5:001, Section 16(6)(a), which require that test-period adjustments are to be made to the base period. It also asserted that the AG's adjustment is founded on an arbitrary and unsupported 50 percent reduction factor.[33] Atmos-Ky. explained that the sale of Atmos's Missouri, Illinois, Iowa, and Georgia operations, all of which were part of the Kentucky/Mid-States' division, increased its share of allocated costs from both DGO and SSU, which increased its test-year payroll and benefits expense levels.[34] It stated that the payroll and benefits amounts included in its forecasted test year are consistent

[31] Ostrander Corrected Testimony at 37-38.

[32] *Id.* at 42.

[33] Surrebuttal Testimony of Joshua C. Densman ("Densman Surrebuttal") at 5-6.

[34] Rebuttal Testimony of Jason L. Schneider ("Schneider Rebuttal") at 4.

with the Commission's regulation for forecasted test periods and that said amounts are the most reasonable forecasts of payroll and benefits for the test year.[35]

The Commission does not accept the AG's recommended adjustment. While the increases in some items between Atmos-Ky.'s fiscal year 2012 and the forecasted test period are notable, it is clear that a major contributing factor was the sale of other Atmos properties, which increased the amounts allocated to Atmos-Ky. The provisions of 807 KAR 5:001, Section 16(6)(a), which dictate how an applicant utility is to present its test year when it uses a forecasted test period, do not govern nor limit an intervenor's analysis of the test year. However, the AG's use of Atmos-Ky.'s 2012 fiscal year as the benchmark to which he compared the test period is not persuasive. Furthermore, although there are instances in which a sharing by ratepayers and shareholders is the basis for reducing a cost by 50 percent for ratemaking purposes, in this instance it does not appear that such a sharing was the intent, but that the AG's use of 50 percent was arbitrary and unsupported, as Atmos-Ky. claimed. For these reasons, we reject the AG's adjustment to reduce Atmos-Ky.'s test year payroll and benefits expense.

Inflation Factor

To forecast "Other O&M" (operating expenses other than (1) labor, (2) benefits, (3) rent, maintenance and utilities, and (4) bad debt) for the test year, Atmos-Ky. applied an inflation factor of 2.7 percent using the approved expense levels in its fiscal year

[35] Densman Surrebuttal at 8-9.

2013 as the starting point.[36] This inflation factor was the average inflation rate for the Midwest region for the last three years, as reported by the U.S. Department of Labor.[37]

The AG opposed Atmos-Ky.'s use of an inflation factor to forecast test-period expenses and proposed an adjustment of $496,907 to remove the impact of inflation. The AG stated that Atmos-Ky. had not met a reasonable burden of proof regarding this item and did not show that there was a proper correlation between its generic inflation factor and the actual historic changes in the expenses to which it applied the inflation factor.[38] He argued that use of the Consumer Price Index ("CPI") was inappropriate because the ". . . CPI basket of goods and services is not representative of Atmos' expenses" and that Atmos had not addressed or reconciled this inconsistency.[39] The AG noted that his proposed adjustment reflected his belief that Atmos-Ky. had applied the inflation factor to both test-period and base-period expenses.[40]

On rebuttal, Atmos-Ky. stated that it did not apply the inflation factor to its base-period expenses. It described an error in the AG's calculation of the amount to which he applied the percent inflation factor in the test year.[41] After adjusting for these items, the correct impact of Atmos-Ky.'s use of the inflation factor is an expense increase of

---

[36] For insurance expense, Atmos-Ky. applied a 5 percent inflation factor reflect that to recent increases in insurance costs have been greater than increases in the other components of "Other O&M."

[37] Direct Testimony of Joshua C. Densman ("Densman Testimony") at 15.

[38] Ostrander Corrected Testimony at 12.

[39] *Id.* at 13.

[40] *Id.* at 16 and 22-23.

[41] Densman Rebuttal at 2-5.

$171,804.[42] Atmos-Ky. stated that use of an inflation factor for a forecasted test year is appropriate and that its methodology is consistent with what has been used in prior cases.[43]

While it has on occasion accepted inflation-related adjustments for individual expense items,[44] the Commission has not been, and is not now, inclined to accept an expense level based on application of a standard, or generic, inflation factor to a mix of approximately a dozen different cost categories ranging from Vehicles and Equipment to Travel and Entertainment. Commission orders in prior cases stated the Commission's view on this type of CPI-based proposal by finding that using the CPI relies "...upon too large and diverse a group of goods and services." In its decision involving the water rates of the city of Lawrenceburg, the Commission also stated that the adjustment proposal "...must provide an accurate measurement of changes in the cost of providing water service. It therefore should be based principally on those goods and services that are reasonably likely to be used to provide water service."[45] The Commission reasoned that a proper adjustment "...should reflect all changes in the cost of the inputs that are required to provide water service" (emphasis in original) and that

[42] *Id.* at 5.

[43] *Id.*

[44] Case No. 2012-00520, *Application of Kentucky-American Water Company for an Adjustment of Rates Supported by a Fully Forecasted Test Year* (Ky. PSC Oct. 25, 2013) at 34-35.

[45] Case No. 2006-00067, *Proposed Adjustment of the Wholesale Water Rate of the City of Lawrenceburg, Kentucky* (Ky. PSC Nov. 21, 2006) at 3-4.

reliance on the CPI would "...not reflect any reductions in the cost of service, only increases."[46]

Finding no persuasive reason to depart from its previous decisions on the reasonableness of basing cost increases on a generic inflation factor, the Commission denies Atmos-Ky.'s proposal.[47] With the corrections to the AG's adjustment provided in Atmos-Ky.'s rebuttal, the result is a $171,804 reduction in test-year operating expenses.

DGO and SSU Allocated Expenses

Atmos-Ky. included $10,876,844 and $13,071,350 in allocated expenses from DGO and SSU in its base period and test period, respectively. It stated that the budget development procedures used to develop its Kentucky budget are also used to develop the budgets of DGO and SSU.[48] Atmos-Ky. explained that costs incurred at DGO and SSU are allocated according to the Cost Allocation Manual ("CAM"), which was developed by Atmos at the corporate level and which is applied uniformly for the allocation of common costs in all states in which Atmos has regulated utility operations.[49]

Based on the difference between the allocated expenses in the test year and the actual allocated expense of $10,086,333 incurred by Atmos-Ky. in its 2012 fiscal year, the AG proposed an adjustment to reduce the test-year amount by $1,492,500.[50] Citing

---

[46] *Id.*

[47] To reiterate something brought out in the hearing, while Atmos-Ky.'s proposal is consistent with that used in prior cases, those cases were settled and did not require a Commission decision.

[48] Densman Testimony at 7.

[49] Direct Testimony of Jason L. Schneider ("Schneider Testimony") at 14.

[50] Ostrander Corrected Testimony at 25.

the increases in DGO and SSU allocated expenses from 2012 to the test period, after Atmos-Ky. experienced three consecutive years of decreases in these expenses, the AG characterized the increases as "significant and unusual" and claimed that Atmos-Ky. did not provide adequate explanation and documentation in support of such increases.[51]

On rebuttal Atmos-Ky. asserted that the overriding reason for the increases in its share of the expenses allocated from DGO and SSU are changes in the factors used in determining the allocations among Atmos's divisions and affiliates.[52] It explained that the principal driver of changes in the allocation factors and its increased levels of DGO and SSU expenses was the 2012 sale of Atmos's Missouri, Illinois, and Iowa operations and the 2013 sale of Atmos's Georgia operations.[53] Atmos-Ky. stated that the same cost allocation methodology had been applied consistently in accordance with its CAM since the 2001 inception of the CAM.[54] It also stated that use of that methodology had resulted in decreases in allocated DGO and SSU expenses in the past.[55]

The Commission does not find the AG's position to be persuasive and will not approve his proposed adjustment. It is unfortunate for its ratepayers that Atmos-Ky.'s share of expenses incurred at the DGO and SSU levels has been increasing; however, it has adequately explained that the sale of Atmos's operations in other states, all of which were in the Kentucky/Mid-States division, caused the increases. Furthermore, it

[51] *Id.* at 30-32.

[52] Schneider Rebuttal at 6.

[53] *Id.* at 5-6.

[54] Schneider Testimony at 14.

[55] Schneider Rebuttal at 5.

has provided the revised allocation factors on which its current allocation is based, and these support its stated position. Accordingly, the AG's proposed adjustment is denied.

Employee Incentive Pay

Atmos-Ky. included $1,164,455 in employee incentive pay in its forecasted test-period operating expenses. The incentive pay reflects the following three plans under which different groups of employees are compensated: (1) Long-Term Incentive Plan; (2) Management Incentive Plan; and (3) Variable Pay Plan.[56]

The AG recommended an adjustment that would eliminate half, or $582,228, of the incentive pay expense from rate recovery.[57] As support for his recommendation, the AG noted that all three plans awarded incentives based on a measure of earnings per share ("EPS"), meaning they were tied to financial results of which shareholders were the primary beneficiary.[58] Because the plans are focused more on shareholder-driven goals, the AG recommended that the costs be shared equally between shareholders and ratepayers, with the shareholder portion being removed for ratemaking purposes.[59]

Atmos-Ky. opposed the AG's adjustment, stating that it was not unique in making incentive compensation part of the overall compensation package offered to employees, and that its total compensation package is designed to be in the middle of the job market in which it competes for talent.[60] Atmos-Ky. claimed that its incentive pay

[56] Responses to AG-1, Items 58, 60, and 61.

[57] Ostrander Corrected Testimony at 43.

[58] *Id.* at 45.

[59] In his post-hearing brief the AG urged that we disallow any incentive compensation.

[60] Densman Rebuttal at 13.

criteria provide benefits to customers because, in order for the criteria to be met, all of its employees must work together to ensure that it operates efficiently and effectively, which translates into lower costs and lower rates for customers.[61]

The Commission is in general agreement with the AG on this matter. Incentive criteria based on a measure of EPS, with no measure of improvement in areas such as safety, service quality, call-center response, or other customer-focused criteria, are clearly shareholder-oriented. As noted in the hearing on this matter, the Commission has long held that ratepayers receive little, if any, benefit from these types of incentive plans.[62] Regarding Atmos-Ky.'s contention that customers benefit because its plans incentivize employees to work together to achieve efficiency and effectiveness, which translates into lower costs and lower rates, it is worth noting that Atmos-Ky.'s witness on this issue stated his belief that employees would strive to do what is right and do a "good job" without these additional incentives.[63] It has been the Commission's practice to disallow recovery of the cost of employee incentive plans that are tied to EPS or other earnings measures and we find Atmos-Ky.'s argument to the contrary unpersuasive. Accordingly, we will remove the full amount, $1,164,455, from test-period operating expenses for ratemaking purposes.

Customer Service System ("CSS") Costs

In 2013, Atmos implemented a new CSS to replace a legacy system that had been in service since the mid-1990s. The total cost of the new CSS is approximately

[61] *Id.* at 14.

[62] Cross-examination of Joshua C. Densman, Jan. 23, 2014 Hearing at 16:24:54 – 16:28:09.

[63] *Id.* at 16:19:10 – 16:20:29.

$78.9 million, of which $4.5 million is allocated to Atmos-Ky.[64] The initial estimated cost of the system was $64 million, based on a planned two-phase implementation. Upon determining that a single-phase implementation was more favorable, Atmos revised its estimate to $72 million. Ultimately, the system's final installed cost was $78.9 million, with the additional $6.9 million largely due to the addition of internal resources needed to test the system prior to its implementation.[65]

The AG proposed an adjustment to reduce test-year expenses by $97,599 to recognize imputed cost savings related to implementing the new CSS.[66] The AG based the adjustment on estimated efficiencies and cost savings provided at Atmos Board of Director meetings, the increase in the cost of the CSS, and his belief that "Atmos must have anticipated certain quantitative and qualitative benefits related to implementation under the single stage approach (versus the 2-stage approach) and that these benefits should be shared with ratepayers. . . ."[67] The AG also proposed to reduce rate base by $426,751 to eliminate one-half of the increase in the CSS's capital cost.

Atmos-Ky. contested the AG's proposals, stating that Atmos's internal projections of potential savings made nearly four years ago should not be binding.[68] It claimed that the AG was incorrect in his assumption that the capital cost over and above the initial

[64] Response to AG-2, Item 36.a.

[65] Response to AG-1, Item 97.

[66] Ostrander Corrected Testimony at 49.

[67] *Id.* at 50.

[68] Atmos-Ky.'s post-hearing brief at 36.

project estimate should generate a higher level of operational efficiencies.[69] Atmos-Ky. asserted that there were two primary drivers of the increase above the original estimate of capital investment: (1) changing the implementation approach from two-phase to single-phase; and (2) the increase in internal resources above those originally estimated for testing of the system prior to its "going live."[70] It stated that the decision to alter the implementation approach and invest more in testing the system was made to ensure that the implementation was successful and seamless for customers and was not made to increase the scope of the system or add functionality to it.[71]

The Commission agrees with Atmos-Ky. that nearly four-year-old internal savings projections of the new CCS should not be binding in this situation. We find Atmos-Ky.'s explanation of the changes to the CCS project (ensuring that the implementation was successful and seamless for customers), which caused the final capital cost to exceed the initial estimate, to be reasonable. Likewise, we also find that there is inadequate support for the assumptions on which the AG's proposed adjustments are based. Therefore, the Commission will not adopt the AG's proposed expense and rate-base adjustments related to the implementation of the new CSS.

PRO FORMA ADJUSTMENTS SUMMARY

The effect of the Commission's accepted adjustments on Atmos-Ky.'s pro forma test-period operations is as follows:

---

[69] Rebuttal Testimony of Gregory K. Waller at 2.

[70] *Id.*

[71] *Id.*

	Atmos-Ky. Forecasted Test Period	Commission Accepted Adjustments	Commission Adjusted Test Period
Operating Revenues	$155,374,969	$ -0-	$ 155,374,969
Operating Expenses	141,914,891	(863,444)	141,914,447
Net Operating Income	$ 13,460,078	$ 863,444	$ 14,323,522

RATE OF RETURN

Cost of Debt

Atmos-Ky. proposed a cost of long-term debt for the test period of 6.19 percent, based on the forecast of total long-term debt expected to be in place on November 30, 2014.[72] Because Atmos-Ky. proposed to exclude short-term debt from its capital structure, it likewise did not propose to include the cost of short-term debt. Information provided in Atmos-Ky.'s application was sufficient to show that the average short-term debt for the test period is 1.25 percent.[73]

The Commission finds that the cost of long-term debt should be 6.19 percent. Consistent with its finding that short-term debt should be included in Atmos-Ky.'s capital structure, it further finds that the 1.25 percent average cost of short-term debt set out in the application should be used in calculating Atmos-Ky.'s rate of return.

Return on Equity

Atmos-Ky. recommends an ROE ranging from 10 percent to 11.3 percent, and specifically requests in its application an ROE of 10.7 percent based on its discounted cash flow model ("DCF"), the ex ante risk premium method, the ex post risk premium

[72] Application, Schedule J-3.

[73] Application, Schedule J-2.

method, and Capital Asset Pricing Model ("CAPM").[74] In its response to Item 48 of Staff's Second Request, Atmos-Ky. recommended an updated ROE of 10.6 percent.

To perform the analysis in support of Atmos-Ky.'s recommendation, Dr. James H. Vander Weide employed two comparable risk proxy groups. The first group consists of nine natural gas companies. Each company is in the natural gas distribution business; paid quarterly dividends over the last two years; had not decreased dividends over the last two years; had an available I/B/E/S long-term earnings growth estimate;[75] and was not involved in an ongoing merger. Each also has an investment grade bond rating and a *Value Line Investment Survey* ("*Value Line*") Safety Rank of 1, 2 or 3.[76] The second proxy group consists of seven water companies included in *Value Line Standard and Plus Editions* that: pay dividends; did not decrease dividends during any quarter for the past two years; have an I/B/E/S long-term growth forecast; and are not part of an ongoing merger.[77] Dr. Vander Weide stated that water utilities are included as a proxy group because the sample size of natural gas utilities is relatively small; water utilities are a reasonable proxy for investing in natural gas utilities in terms of risk; natural gas

[74] Direct Testimony of James H. Vander Weide at 3-4.

[75] *Id.* at 25. I/B/E/S, a division of Thomson Reuters, reports analysts' EPS growth forecasts for a broad group of companies. The I/B/E/S growth rates are widely circulated in the financial community, include the projections of reputable financial analysts who develop estimates of future EPS growth, are reported on a timely basis to investors, and are widely used by institutional and other investors.

[76] *Id.* at 25.

[77] *Id.* at 28.

utilities are frequently used as proxies for water utilities in water cases;[78] and that the cost-of-equity results for a group of similar-risk companies is useful to examine as a test for the reasonableness of the cost-of-equity results for natural gas utilities.

Dr. Vander Weide applied a quarterly DCF model to the gas and water proxy groups. His DCF study uses analysts' estimates of forecasted EPS growth reported by I/B/E/S and *Value Line* to compute the growth rate expected by investors. The initial DCF analysis filed in Exhibit JVW-1, Schedule I of the application sets out a "market-weighted average" for the gas proxy group utilities of 10 percent, including flotation cost. In response to a Staff information request, Atmos-Ky. stated that the simple average of the DCF analysis for the original proxy group, including flotation cost, is 9.7 percent; the market-weighted average, excluding flotation cost, is 9.7 percent; and that the simple average DCF ROE is 9.5 percent if flotation costs are excluded.[79] On November 15, 2013, Atmos-Ky. provided an update to its DCF analysis which showed a market-weighted average ROE of 9.9 percent, including flotation cost, for the eight gas proxy group utilities remaining after New Jersey Resources was excluded based on its DCF result's being so low that it failed Dr. Vander Weide's outlier test.[80] Model results for the individual companies are sufficient to show that the DCF analysis produces a simple

[78] In the final Orders in Case Nos. 2010-00036, *Application of Kentucky-American Water Company for an Adjustment of Rates Supported by a Fully Forecasted Test Year* (Ky. PSC Dec. 14, 2010) and 2012-00520, *Application of Kentucky-American Water Company for an Adjustment of Rates Supported by a Fully Forecasted Test Year* (Ky. PSC Oct. 25, 2013) the Commission found the use of natural gas utilities as proxies for water utilities to be inappropriate.

[79] Response to Staff's Second Request, Item 44.

[80] Atmos-Ky. Responses to Hearing Discovery Request, Question 1-10.

average ROE of 9.56 percent, including flotation cost, as updated by Atmos-Ky. on November 15, 2013, after the exclusion of New Jersey Resources' DCF result.[81]

For the water utility group, the DCF analysis produced a simple average ROE of 10.6 percent, with flotation costs, and a market-weighted average ROE of 11 percent. Atmos-Ky.'s response to Item 44 of Staff's Second Request indicated that, without flotation costs, the DCF results produced a simple average ROE of 10.4 percent and a market-weighted average ROE of 10.8 percent. Atmos-Ky.'s November 15, 2013 update showed a simple average DCF of 9.9 percent, with flotation costs, for the water group, and a market-weighted average ROE of 10.8 percent, including flotation costs.

Dr. Vander Weide relied upon data of gas distribution utilities for the ex ante risk premium ROE estimation and used a forecasted yield to maturity ("YTM") on A-rated utility bonds. The cost of equity produced by the ex ante risk premium is 11.3 percent, using a forecasted 6.55 percent forecasted YTM on A-rated utility bonds. For the ex post risk premium ROE estimation, Dr. Vander Weide relied upon stock price and dividend data from Standard & Poor's ("S&P") 500 stock portfolio and from Moody's A-rated Utility Bonds bond yield data. Using this method, the expected ROE is 10.4 to 10.9 percent with a mid-point of 10.6 percent, to which Dr. Vander Weide added an allowance for flotation cost to achieve an ROE of 10.8 percent. This calculation also included a forecasted YTM on A-rated utility bonds of 6.55 percent. In response to Item 47 of Staff's Second Request, Dr. Vander Weide confirmed that the Moody's average A-rated utility bond yield as of February 2013 was 4.18 percent. Using the 4.18 percent

[81] New Jersey Resources' DCF Model Result as shown in Exhibit JVW-1, Schedule 1, of the application is 8.3 percent.

YTM as opposed to the forecasted 6.55 percent YTM produced ROEs of 10.3 percent for the ex ante risk premium and 8.5 percent for the ex post risk premium. Dr. Vander Weide stated in his response to Item 47 that the use of the 4.18 percent bond yield produces an unreasonably low cost-of-equity estimate, and noted that as of August 14, 2013, the average utility bond yield had risen to approximately 4.9 percent. When Atmos-Ky. provided updated information to Staff's Second Request on November 15, 2013, the ROE produced by the ex ante risk premium remained unchanged at 11.3 percent, and the ROE produced by the ex post risk premium had risen to 10.9 percent, including flotation cost and using the forecasted 6.55 percent YTM.

Dr. Vander Weide performed both historical and DCF-based CAPM analyses, producing ROEs of 10.2 and 10.6 percent, respectively, using forecasts of long-term Treasury bond yields; market-weighted average betas; and including flotation cost. Atmos-Ky.'s November 15, 2013 update included CAPM analyses with more current data. The historical CAPM ROE from that updated information was 10.34 percent, while the updated DCF-based CAPM ROE was 10.8 percent, both using an updated market-weighted average beta of .74. That update included a calculation showing that the simple average beta was .69 percent. For comparison purposes, the Commission notes that substituting the simple average beta of .69 for the market-weighted average beta results in ROEs of 10.01 percent and 10.18 percent, respectively, including flotation cost, for the historical and DCF-based CAPM analyses. Dr. Vander Weide concludes in his direct testimony that the cost-of-equity model results derived from CAPM should be given less weight for purpose of estimating the cost of equity because it underestimates the cost of equity for companies with betas significantly less than 1.0.

In its post-hearing brief, Atmos-Ky. discussed the introduction of a Regulatory Research Associates ("RRA") report at the hearing which described average allowed ROE of all electric and gas utilities rate cases for 2013. It expressed concern regarding any "over reliance on a simple average return"; stated that the introduction of the report at the hearing implied that the average allowed return on equity could serve as a guide to the Commission; and enumerated the attendant problems if that were the case. Atmos-Ky. discussed in its brief the information it provided in response to Commission and Staff requests during the hearing, citing ROEs of Atmos's distribution companies on average, Atmos-Ky.'s current PRP program ROE resulting from the settlement of its last rate case, and Atmos Mississippi's ROE, all of which are currently over 10 percent.[82]

The AG's post-hearing brief referenced the ROE included in a recent settlement of an Atmos rate proceeding in Colorado, comparing the 9.72 percent ROE from that case to the 9.83 percent average ROE for gas utilities for the fourth quarter of 2013 and to the overall 2013 average ROE for gas utilities of 9.68 percent, as reported in the RRA report introduced at the hearing.[83] The AG concluded in his brief that, based on the national average allowed ROEs for gas utilities in 2013, an ROE of 9.68 percent, will provide more than a sufficient return to attract capital investment.

Having considered and weighed all the evidence in the record concerning the appropriate ROE for Atmos-Ky., the Commission finds a range of 9.3 percent to 10.3 percent to be reasonable. Within this range, an ROE of 9.8 percent will best allow Atmos-Ky. to attract capital at a reasonable cost, maintain its financial integrity to

[82] Atmos-Ky.'s post-hearing brief at 43-44.

[83] AG's post-hearing brief at 27.

ensure continued service, provide for necessary expansion to meet future requirements, and result in the lowest possible cost to ratepayers. In reaching our finding, we have excluded adjustments for flotation cost and have placed greater emphasis on the DCF and the CAPM model results of the gas utility proxy group. While recognizing that historical data has some value for use in obtaining estimates, we have given considerable weight to analysts' projections regarding future growth in the application of the DCF model. Finally, in assessing market expectations, we have recognized the importance of present economic conditions.

With regard to Atmos-Ky.'s concern about the aforementioned RRA report, this Commission does not rely on returns awarded in other states in determining the appropriate ROE for Kentucky jurisdictional utilities. It is reasonable to expect that other commissions, each with its own attributes, are evaluating expert witness testimony which uses the same or similar cost-of-equity models and an array of proxy groups, and reaching conclusions based on the data provided in the records of individual cases. The conclusions reached by those commissions, as well as this Commission, as to reasonable ROEs for a constantly changing group of utilities during different time periods are summarized periodically by RRA with explanatory reference points and are available to investors. To the extent that investors' expectations are influenced by such information, we believe that our 9.8 ROE will not appear unreasonable.

Rate of Return Summary

Applying Atmos-Ky.'s rates of 6.19 percent for long-term debt, 1.25 percent for short-term debt, and 9.8 percent for common equity to the approved capital structure

produces an overall cost of capital of 7.71 percent. The Commission finds this overall cost of capital to be fair, just, and reasonable.

REVENUE REQUIREMENTS

Based upon Atmos-Ky.'s rate base of $252,737,721 and an overall cost of capital of 7.71 percent, the net operating income that could be justified for Atmos-Ky. is $19,486,482. Recognizing the adjustments found reasonable herein, Atmos-Ky.'s pro forma net operating income for the test year is $14,323,522. Based on the difference in these two amounts, Atmos-Ky. would need additional annual operating income of $5,189,538. After recognizing the provision for uncollectible accounts, state and federal income taxes, and the PSC Assessment, Atmos-Ky.'s revenue deficiency would be $8,550,134. The calculation of the revenue deficiency is as shown below:

Net Operating Income Deficiency	$5,189,538
Divide By Gross Up Revenue Factor	0.606954
Overall Revenue Deficiency	$8,550,134

PRICING AND TARIFF ISSUES

Cost-of-Service Study

Atmos-Ky. presented a fully allocated class cost-of-service study ("COSS") for the purpose of distributing revenue requirements among rate classes and determining rates of return on rate base at present and proposed rates for the following rate classes: Residential, Commercial and Public Authority, Firm Industrial, and Interruptible and Transportation. Atmos-Ky. revised the COSS in response to Staff's Third Information Request ("Staff's Third Request") and again when it filed its rebuttal testimony.[84]

[84] Rebuttal Testimony of Paul H. Raab ("Raab Rebuttal"), Exhibit PHR-3.

Atmos-Ky.'s revised COSS indicated that, at present rates, class rates of return on rate base are: 1.5627 percent for Residential, 10.1022 percent for Commercial and Public Authority, .6805 percent for Firm Industrial, and 26.3634 percent for Interruptible and Transportation.[85] The total company rate of return is 5.3220 percent.[86] The rates of return at Atmos-Ky.'s proposed rates would be: 4.3323 percent for Residential, 15.0922 percent for Commercial and Public Authority, 4.3633 percent for Firm Industrial, and 29.6414 percent for Interruptible and Transportation.[87] Total company rate of return on rate base would be 8.5299 percent.[88] At proposed rates, Atmos-Ky.'s COSS shows that its proposed revenue allocation results in the class rates of return moving closer to an equalized rate of return.

Atmos-Ky. filed a Customer/Demand COSS utilizing a combination of peak day demands and customer number in allocating the cost of distribution mains. Atmos-Ky. used design day demand, stating that it was the most appropriate allocation method since its "transmission plant is built to meet the highest simultaneous peak established by customers."[89] Using a zero-intercept method in developing its classification factor for distribution mains, Atmos-Ky. classified them as approximately 85 percent customer-

---

[85] *Id.* at p. 1. The COSS filed with the application shows only the Residential class providing less than the system average return at present rates. The revised COSS filed as Exhibit PHR-3 shows both the Residential and Firm Industrial classes providing less than the system average return at present rates.

[86] *Id.*

[87] *Id.*

[88] *Id.*

[89] Direct Testimony of Paul H. Raab at 9.

related and 15 percent demand-related.[90] Atmos-Ky. states that this classification is consistent with classifications it proposed and the Commission accepted in its previous rate proceedings. It also states that the Commission approved a similar zero-intercept COSS used by Delta Natural Gas Company ("Delta") in Case No. 2010-00116.[91]

The AG submitted an alternate Peak and Average COSS in the testimony of witness Glen Watkins.[92] Although certain minor differences exist between the two COSSes, Atmos-Ky. and the AG agree that the primary difference lies in the treatment of distribution mains. The AG's COSS allocates distribution mains based on both peak day and annual throughput. The AG states that the Peak and Average method is the most equitable method for assigning the costs of natural gas distribution mains because it recognizes utilization of the facilities throughout the year, but also recognizes that some classes rely on the facilities more than others during peak periods. The AG argues that in Atmos-Ky.'s COSS, 87 percent of the costs of service are allocated based on the number of customers regardless of their utilization of the system and that this places an unfair burden on residential customers.[93]

On Rebuttal, Atmos-Ky. states that its COSS recognizes that some classes rely upon the facilities more than others during peak periods because it allocates a portion of distribution mains on the basis of customer class peak demand. Atmos-Ky. contends that "each class's utilization of the Company's facilities throughout the year" has no

---

[90] *Id.* at 12.

[91] Case No. 2010-00116, *Application of Delta Natural Gas Company, Inc. for an Adjustment of Rates* (Ky. PSC Oct. 21, 2010).

[92] A Peak and Average COSS is sometimes referred to as a Demand/Commodity COSS.

[93] AG's post-hearing brief at 25.

bearing on the cost being allocated. It argues that it uses a network model to plan its system which considers only the number of customers to be served and their peak demands.[94] Finally, Atmos-Ky. makes reference to page 28 of the National Association of Regulatory Utility Commissioners Manual on Gas Rate Design dated August 6, 1981, and states that the only commodity-related costs identified are those related to the acquisition of natural gas, consistent with its COSS results. Atmos-Ky. concedes that ". . . there is no 'absolute' cost of service analysis that can be relied on by the Commission in all cases to guide the allocation of costs, and that whatever cost allocation methodologies are chosen should be used as a 'guide' rather than as an absolute prescription for rate design."[95] Atmos-Ky. states, however, that when making a determination on which set of results to use as a guide in rate design, the Commission should consider whether the COSS sponsor has a particular constituency for which it is advocating. Atmos-Ky. contends that, when choosing allocators, Mr. Watkins chose those that would benefit the residential class.[96] Atmos-Ky. argues that it must take a broader view of what is fair and reasonable when making allocation decisions.

Based upon its review of Atmos-Ky.'s and the AG's COSS, the Commission finds that a Peak and Average COSS such as the AG proposed reflects a reasonable methodology. However, we also find the methodology used by Atmos-Ky. to be reasonable and, with a greater amount of detail included so that the functionalization

---

[94] Raab Rebuttal at 14.

[95] *Id.* at 4.

[96] *Id.* at 7.

and classification in its COSS could be seen, represents an acceptable starting point in determining rate design in this proceeding.

Other COSS-Related Issues

Atmos-Ky. acknowledged that there is support for the approach used by the AG in previously filed COSSes in other jurisdictions.[97] In addition, Atmos-Ky. stated that "[b]oth approaches utilize traditional and accepted classification and allocation methods and yet produce widely divergent results of the 'cost of service.'" It was for this reason that, in Case No. 10201,[98] the Commission encouraged Columbia to submit multiple-methodology COSSes in its future rate proceedings. The Commission reaffirmed this position in Case No. 90-013[99] when it encouraged Atmos-Ky.'s predecessor, Western, as well as other utility companies and intervenors, to file well-documented alternative and multiple-methodology COSSes to provide additional information for rate design. We continue to believe that such an approach to COSSes is appropriate and beneficial. Hence, the Commission strongly encourages Atmos-Ky. to file multiple-methodology COSSes in future rate cases in order to give the Commission a range of reasonable results for use in determining revenue allocation and rate design.[100]

---

[97] *Id.* at 5.

[98] Case No. 10201, *An Adjustment of Rates of Columbia Gas of Kentucky, Inc.* (Ky. PSC Oct. 21, 1988).

[99] Case No. 90-013, *Rate Adjustment of Western Kentucky Gas Company* (Ky. PSC Sept 13, 1990) at page 50.

[100] In considering methodologies, Atmos is reminded the Commission voiced its concerns in the past with "methodologies that place all the emphasis on maximum design day as a way to allocate costs. This method may result in an inappropriate shift of costs to the residential customer class. For this reason, cost-of-service methodologies should give some consideration to volume of use." Administrative Case No. 297, *An Investigation of the Impact of Federal Policy on Natural Gas to Kentucky Consumers and Suppliers* ("Admin. 297") (Ky. PSC May 29, 1987), Order at 47.

The Commission notes that the AG's COSS in this proceeding failed to show the steps of functionalization and classification. When asked in an information request to provide the COSS electronically with all three steps shown separately, the AG provided an electronic copy that shows only the allocation step. When asked during the formal hearing to provide the COSS showing the omitted steps, Mr. Watkins stated that he had not performed the first two steps, and would not be able to provide it unless he was compensated.[101] As was stated in Admin. 297, the Commission prefers that COSS be disaggregated to the greatest extent possible[102] so that the functionalization and classification, as well as allocation, are available for review. Absent an analysis showing all steps of the COSS, the Commission is unable to fully analyze the COSS and therefore is unable to give it the same consideration as a study that includes an analysis of all three steps. With this Order, the Commission puts all parties to future rate proceedings on notice that we cannot give full consideration to a COSS that does not show separately each of the typical individual COSS steps of functionalization, classification, and allocation.

Revenue Allocation

According to Atmos-Ky., while the results of its COSS show that all customer classes except the residential class contribute adequately to its cost of service, it chose to allocate a portion of the requested revenue increase to each customer class.[103] It

[101] January 23, 2014 hearing at 19:32:25.

[102] Admin. 297 (Ky. PSC May 29, 1987), Order at at 42-43.

[103] As stated previously, the revised COSS filed as Exhibit PHR-3 shows both the Residential and Firm Industrial classes providing less than the system average return at present rates.

proposed to increase the customer charges and volumetric rates of all classes with the exception of special contract customers, and to allocate greater increases to volumetric charges as opposed to fixed monthly customer charges.[104] Atmos-Ky.'s proposed allocation of its requested base-rate increase results in maintaining approximately the same percentage of total revenue responsibility among customer classes as exists at current rates.[105]

The AG recommended base-rate revenue increases for all customer classes as well, with lesser increases allocated to firm-sales customers, and with greater increases allocated to firm-transportation, and interruptible-sales and transportation customers. The AG recommended that revenue increases allocated to firm-sales customers be recovered via increases in volumetric rates only, with no increase in monthly customer charges for firm-G-1-sales customers.[106]

The AG also recommended imputing an approximately $3 million increase in base-rate revenues to special-contract customers or to Atmos shareholders.[107] The AG asserted that 50 percent of the tariff rate discounts attributable to 17 special contracts with 16 industrial customers subject to bypass threat should be borne by either those customers or shareholders, with the other 50 percent borne by other customers.[108] The AG stated in his post-hearing brief that it is possible some special contract customers

[104] Martin Testimony at 24.

[105] January 23, 2014 hearing at 11:58:06.

[106] Direct Testimony of Glenn A. Watkins at 44-45.

[107] *Id.* at 45.

[108] AG's post-hearing brief at 11-12.

are legitimate bypass threats, but that "it is likely that some of these contracts are unreasonable and some of the special contract customers are not legitimate threats to bypass Atmos."[109] The AG also recommended that the Commission require Atmos-Ky. to provide an analysis of the reasonableness of the special contracts and whether they represent legitimate bypass threats. A similar analysis was a provision in the settlement agreement between the AG and Columbia Gas of Kentucky, Inc. ("Columbia") in Case No. 2013-00167[110] after the AG raised the same concern regarding the continued reasonableness of special contracts in that case. In the Commission's final Order approving the settlement agreement, we ordered Columbia to submit the results of its analyses on the threat of bypass by its special contract customers as part of its next application for an adjustment of its base rates.

Responding to the AG's proposal to impute $3 million of special-contract revenue discounts to special-contract customers or Atmos shareholders, Atmos-Ky. asserted in its post-hearing brief that all its special contracts were filed with the Commission; were supported by financial analysis demonstrating that they generated revenue sufficient to cover all variable costs and make a contribution to fixed costs; were reviewed, accepted and stamped by the Commission; and that the revenues generated were included in each subsequent rate case before the Commission. Atmos-Ky. claimed that physical bypass of its system remains a viable option for each special-contract customer, and

[109] *Id.* at 12.

[110] Case No. 2013-00167, *Application of Columbia Gas of Kentucky, Inc. for an Adjustment of Rates for Gas Service* (Ky. PSC Dec. 13, 2013).

that it would be unwarranted and unjust to disallow the revenue discounts from its previously approved contracts.[111]

The Commission agrees with both Atmos-Ky. and the AG that increases should be allocated to all sales and transportation rate classes. We do not agree, however, that it is reasonable to impute a rate increase to special-contract customers. With regard to the AG's proposal to impute $3 million in revenue responsibility to special-contract customers, or to Atmos shareholders if Atmos-Ky. is not able to raise the rates of those customers, the Commission finds that there is no basis in the record of this proceeding to do so. Atmos-Ky. established to the Commission's satisfaction at the time of filing the special contracts that they generated revenue sufficient to cover the variable costs related to serving each customer and make contributions to fixed costs. However, the Commission also finds reasonable the AG's recommendation to require Atmos-Ky. to file analyses similar to that required of Columbia in its next base-rate application. The Commission will therefore require Atmos-Ky. to internally conduct and maintain studies, analyses, reports, quantifications, etc., that demonstrate the threat of bypass by each of its special-contract customers, and that the special contracts continue to generate sufficient revenue to cover variable costs and contribute to fixed costs. This information is to be provided in Atmos-Ky.'s next base-rate case application.

The Commission's revenue allocation as reflected in the rates found reasonable herein generally preserves the existing base-rate revenue responsibility among the classes, excluding gas cost.

---

[111] Atmos-Ky.'s post-hearing brief at 47-48.

Rate Design

Atmos-Ky. proposed no change in rate design, maintaining its current monthly base customer charge and declining block volumetric rates for all rate schedules. It proposed to increase the G-1 Firm Sales Service base customer charge to $16.00 for residential customers and to $40.00 for non-residential customers. It also proposed to increase the base customer charge for G-2 Interruptible Sales Service and for T-4 and T-3 Firm and Interruptible Transportation Service customers to $350.00, which is supported by its COSS. Atmos-Ky. proposed to increase volumetric rates for all customer classes, with a greater relative increase allocated to the first block (0 – 300 Mcf) for G-1 firm sales customers and T-4 firm transportation customers.

As mentioned in the discussion on revenue allocation, the AG recommends that Atmos-Ky.'s residential base monthly customer charge not be increased above $14.28, the residential base customer charge, including the Pipe Replacement Program ("PRP") surcharge, in effect when Atmos-Ky. filed its application. The AG stated that any increase awarded to Atmos-Ky. should be allocated to the volumetric delivery charge to give customers the opportunity to lower their bills through conservation.[112] The Commission notes that, based on the $2.61 monthly residential PRP rate we approved effective October 1, 2013 in Case No. 2013-00304,[113] Atmos-Ky.'s residential customers are now paying $15.11 through the combination of the current $12.50 base customer charge and PRP surcharge.

[112] AG's Post-Hearing Brief at 26.

[113] Case No. 2013-00304, *Application of Atmos Energy Corporation to Establish PRP Rider Rates for the 12-Month Period Beginning October 1, 2013* (Ky. PSC Sept. 17, 2013).

The Commission finds Atmos-Ky.'s proposed monthly base customer charges, including the $16.00 residential base customer charge, to be reasonable based on its COSS and the relatively minor increases from the level of monthly customer charges currently paid by all customer classes. Atmos-Ky.'s proposed rate design and customer charges for all customer classes should be approved, and the remainder of the revenue increase awarded herein should be recovered through higher volumetric rates. The volumetric rates approved herein are either identical to or approximate the volumetric rates proposed by Atmos-Ky. for the second and third rate blocks for G-1 firm sales and T-4 firm transportation rate classes; and for both blocks of G-2 interruptible sales and T-3 interruptible transportation customers. The remainder of the increase is recovered through the 0 – 300 Mcf block of firm sales and transportation customers, maintaining more closely the existing relationship between the first rate block and the second and third rate blocks than had been proposed by Atmos-Ky.

Weather Normalization Adjustment

Atmos-Ky. proposed that its Weather Normalization Adjustment ("WNA") be granted permanent approval. Atmos-Ky. points out that Columbia, Delta, and Louisville Gas and Electric Company have all received permanent approval from the Commission of their WNA mechanisms. Atmos-Ky.'s proposed WNA tariff defines normal billing cycle HDD as being based on NOAA's 30-year normal for the period of 1981-2010. In Atmos-Ky.'s post-hearing brief, it alluded to testimony that it is willing to use a different data set for calculating its WNA, but stated its concern that the same data set should be used for normalizing test-year revenues in its rate case as is used for its WNA.

The Commission finds that Atmos-Ky.'s proposal for permanent approval of its WNA is reasonable and should be granted. Atmos-Ky.'s WNA tariff should likewise be approved including the language concerning NOAA's 30-year normal for the period ending 2010. In Atmos-Ky.'s future rate proceedings, this WNA tariff language setting out the time period used should be updated to reflect the time period approved by the Commission to weather normalize revenues in those rate proceedings.

Margin Loss Rider and System Development Rider

Atmos-Ky. proposed to implement two new tariffs, a Margin Loss Rider ("MLR") and a System Development Rider ("SDR"), which it believes will help delay the time and cost associated with a general rate case.[114] Atmos-Ky. proposes the MLR to recover 50 percent of margins lost due to the Economic Development Rider ("EDR"), its Alternative Fuel Flex Provision, or negotiated rates with pipeline bypass candidates. It proposed the lost margin as half the difference between existing tariff rates and the negotiated special contract rates collected over estimated sales volumes of rate schedules G-1 and G-2 (firm and interruptible sales service rate schedules). The proposed MLR tariff contains a Balancing Adjustment provision to reconcile the difference between billed revenues and revenues that would have been billed absent the rider, plus interest at the average the 3-month Commercial Paper Rate for the immediately preceding 12-month period. In support of its proposal, Atmos-Ky. stated that the Commission approved an MLR tariff in a general rate proceeding of Atmos-Ky.'s predecessor company, Western,

[114] Martin Testimony at 30.

in Case No. 1999-070.[115] That tariff resulted from a unanimous settlement agreement and provided for lost revenues to be shared equally by ratepayers and shareholders.

The SDR is proposed to recover investment related to economic development initiatives for overall system or reliability improvement that cannot be directly assigned to a customer or group of customers. Atmos-Ky. states that the SDR is intended to encourage industrial development, infrastructure investment and job growth within its service area. Atmos-Ky.'s proposed tariff describes the SDR revenue requirement as consisting of the following:

1. SDR-related Plant In-Service not included in base gas rates minus the associated SDR-related accumulated depreciation and accumulated deferred income taxes;

2. Retirement and removal of plant related to SDR construction;

3. The rate of return on the net rate base being the overall rate of return on capital authorized for the Company's Pipe Replacement Program Rider;

4. Depreciation expense on the SDR related Plant In-Service less retirements and removals; and

5. Adjustment for ad valorem taxes.

Atmos-Ky. proposed that the SDR rate be charged to the G-1 and G-2 rate classes in proportion to their relative base revenue shares approved in its most recent rate case.

[115] Case No. 1999-070, *The Application of Western Kentucky Gas Company for an Adjustment of Rates* (Ky. PSC Dec. 21, 1999).

The Commission, in Administrative Case No. 327 ("Admin. 327"),[116] specifically stated that utilities with active EDR contracts should demonstrate through detailed cost-of-service analysis that nonparticipating ratepayers are not adversely affected by EDR customers, and that cost-recovery issues are to be held for general rate proceedings. Atmos-Ky. proposed these same riders in Case No. 2012-00066,[117] in which it stated that EDR promotes an important public purpose similar to pipe-replacement programs and, therefore, it should be permitted to recover its costs on a more current basis.[118] The Commission approved Atmos-Ky.'s EDR in Case No. 2012-00066, but did not approve the MLR and SDR riders. Atmos-Ky. states in its application in the instant proceeding that all customers will share in the benefits of increased industrial development and job creation and as a result should not be considered adversely affected by the proposed MLR and SDR riders. In spite of this claim, Atmos-Ky. stated in response to Item 177 of the AG's First Request for Information and in response to Item 27 of Staff's Third Request that transportation customers would not be expected to benefit as much from development, infrastructure investment, and job growth as G-1 and G-2 sales customers, which are the only customer classes proposed to be subject to the riders.

---

[116] Administrative Case No. 327, *An Investigation into the Implementation of Economic Development Rates by Electric and Gas Utilities* (Ky. PSC Sept. 24, 1990).

[117] Case No. 2012-00066, *Application of Atmos Energy Corporation for an Order Approving Economic Development Riders* (Ky. PSC Aug. 27, 2012).

[118] The Commission acknowledged in the final Order in Case No. 2012-00066 that EDRs promote a public purpose, but stated that it was not persuaded that the purpose is similar to the issue of public safety that is promoted by the pipe replacement programs of Atmos and other gas utilities.

The AG recommended that the MLR not be approved, citing the fact that the MLR was previously approved in a black box settlement and not as a result of a litigated proceeding.[119] The AG stated in his post-hearing brief that Atmos-Ky. should not be awarded an MLR that would encourage future special contracts, which he is concerned would not be responsibly administered. If the Commission approves an MLR for Atmos-Ky., the AG recommends that we impose conditions and exercise ongoing supervision over such a mechanism.[120] The AG had no recommendation with regard to the SDR.

The Commission finds that the record in this proceeding does not support Atmos-Ky.'s need for an MLR or an SDR. In response to hearing requests for information concerning the MLR, Atmos-Ky. stated that, since 2009, it had revenue losses of only $3,543 due to fuel switching through its Alternative Fuel Flex Provision, no revenue losses from new special contracts, and that it has entered into no EDR contracts.[121] The Commission notes that if Atmos-Ky. were to enter into a special contract with an EDR customer, in most instances it should be to add incremental load and that revenue collected from that customer would be in addition to base-rate revenues approved in this rate case. Because Atmos-Ky.'s experience over the last five years does not support the likelihood of revenue losses that would indicate the need for such a revenue-stabilizing mechanism, the Commission finds that the addition of the proposed MLR to Atmos-Ky.'s tariffs is not warranted or reasonable.

---

[119] AG's post-hearing brief at 13.

[120] *Id.* at 14.

[121] Atmos-Ky.'s Responses to Hearing Discovery Requests, Question 1-03.

Atmos-Ky.'s response to Item 5 of Staff's Third Request indicates no revenue loss in the last five years resulting from projects that would have qualified for recovery through the SDR if such a tariff rider had been in use during that time, and that no such projects are contemplated during the period 2014 through 2019. While we support economic development efforts that benefit jurisdictional utilities, their customers, their shareholders, and their service areas as evidenced by the findings in Admin. 327, the Commission finds that the SDR is not warranted or reasonable based on the record of this proceeding. The Commission further finds that its denial of the SDR should be without prejudice for Atmos-Ky. to request the SDR in the future if it experiences increasing opportunities for projects that would be subject to such a mechanism.

General Firm Sales (G-1) & Interruptible Sales (G-2) Natural Gas Vehicle Provisions

Atmos-Ky. proposed to add the same language to its G-1 and G-2 sales tariffs that is contained in its T-3 and T-4 Transportation Service tariffs to accommodate sales customers that would like to offer natural gas as a motor vehicle fuel. The additional language will permit sale of gas delivered to a customer for resale only if the gas is used as a motor vehicle fuel. Atmos-Ky.'s revision to its G-1 and G-2 sales tariffs to permit the sale of natural gas for resale as a motor vehicle fuel is reasonable, is in keeping with its transportation tariffs, and should be approved.

$10 Door Tag Fee

Atmos-Ky. proposed to implement a $10 Door Tag Fee to be charged after a customer's account becomes delinquent and it hangs a door tag at the customer's premises. Atmos-Ky. states that, at times, an employee will drive to the customer's premises and leave a door tag notifying the customer that gas service will be

disconnected if the bill is not paid.[122] The purpose of the fee, according to Atmos-Ky., is to benefit customers by preventing disconnection and potentially eliminating more costly reconnection charges. This fee would be in addition to a $39 reconnect fee a customer is required to pay to re-establish service if the customer is disconnected for non-payment.[123] Atmos-Ky. did not provide any cost justification for the fee, but claimed the fee was nominal and would only help to offset the cost of the employee trip.

In response to a Commission Staff request for information, Atmos stated that it "does not plan on using [the door tags] often, but wanted to reinstitute the option since it was a past practice."[124] During testimony provided at the public hearing, however, Atmos-Ky. noted that it intended that the Door Tag Fee be Implemented on a pilot basis, that its use will be discontinued if it proves to be unsuccessful,[125] and that the fee would be applied to all customers who received a disconnect notice.[126]

The AG took no position on the proposed fee.

Due to the lack of cost support and somewhat inconsistent information provided, the Commission will deny Atmos-Ky.'s request to implement the $10 door tag fee. The Commission is concerned by the fact that, while a customer could benefit by avoiding a more costly $39 reconnect fee, a customer not heeding the door tag would be required to pay $10 in addition to all other fees. Should Atmos-Ky. wish to propose a door tag

---

[122] Martin Testimony at 31-32.

[123] January 23, 2014 hearing at 11:51:45.

[124] Response to Staff's Second Request, Item 27.

[125] January 23, 2014 hearing at 11:52:55.

[126] *Id.* at 11:53:35.

fee in a future application, it should file more supporting details for the fee, including but not limited to the fee's success as a deterrent to non-payment and disconnection in other jurisdictions; cost support justifying the proposed charge; an estimate of revenue to be collected by the fee; and the details of the proposed pilot program if it is to be implemented as a pilot.

Other Tariff Changes

Atmos-Ky. proposed changes to its tariffs to reflect revisions to the Commission's regulations. Through the process of discovery, Atmos-Ky. agreed to further revise its tariffs, and provided amended tariff sheets incorporating all revisions. Atmos-Ky.'s tariff revisions as proposed and as further developed through the process of discovery are reasonable and should be approved.

Gas Transportation Thresholds

In 2010, the Kentucky General Assembly adopted Joint Resolution 141, which directed the Commission to commence a collaborative study of natural gas retail competition programs and to prepare and submit a report to the Kentucky General Assembly and the Legislative Research Commission. Pursuant to that directive, the Commission established Case No. 2010-00146 to conduct an investigation of natural gas competition.[127] After developing a record that consisted of discovery responses, testimony, and public comments, and conducting a public hearing, the Commission concluded that the existing transportation thresholds of jurisdictional local distribution

[127] Case No. 2010-00146, *An Investigation if Natural Gas Competition Programs* (Ky. PSC Dec. 28, 2010).

companies ("LDCs") should be further examined, and that each LDC's tariffs and rate design would be evaluated in its next general rate proceeding.

In its rate application in this proceeding, Atmos-Ky. discusses its transportation and pooling services and its 9,000 Mcf per year volumetric eligibility threshold. It stated its belief that its existing eligibility threshold is set at an appropriate level and proposed no changes to its transportation service. The issue of Atmos-Ky.'s transportation service and eligibility threshold was further developed through the process of discovery by Staff, and was addressed by Stand's March 13, 2014 Brief and by Atmos-Ky.'s March 21, 2014 Reply Brief. Atmos-Ky. established through testimony and responses to discovery that it has approximately 30 customers that qualify for transportation service but choose to stay on sales service;[128] that over the last five years it has received only four requests for transportation service from non-residential customers whose volumetric usage would make them ineligible for transportation service;[129] that up-front costs such as electronic flow metering, monthly administration fees and potential cash out obligations would make it difficult for lower-volume-usage customers to achieve savings;[130] and that its existing transportation service threshold is not an outlier compared to other Kentucky jurisdictional LDCs.[131]

Stand recommends that Atmos-Ky.'s volumetric transportation threshold be lowered to allow more customers to purchase natural gas in the market. Stand states

[128] Martin Testimony at 33-34.

[129] Response to Staff's Second Request, Item 11.

[130] Martin Testimony at 33.

[131] Response to Staff's Third Request, Item 6.

that the Commission should require Atmos-Ky. to lower the threshold from 9,000 to 3,000 Mcf per year if Atmos-Ky. will not do so voluntarily.[132] According to Stand, its suggestion is based on general industry knowledge, the thresholds of other LDCs, and the record in this case and that of Case No. 2010-00146.[133] Stand states that utilities in Kentucky and other states have proven that any risks and dangers of gas transportation are resolved by properly drafted tariffs which are not unduly punitive, do not unduly benefit the utility, and which serve to control supplier behavior.[134] Stand also advises that if the transportation threshold is lowered, the Commission must guard against the risk that other provisions of Atmos-Ky.'s tariff would be made more punitive and restrictive.[135] Stand cites the following as reasons that Atmos-Ky. should be indifferent to whether it or another supplier is supplying gas to its customers: (1) Atmos-Ky. is not allowed to profit from providing sales gas; and (2) Atmos-Ky. charges fees to transportation customers to address system balancing issues. Stand states that these factors justify lowering the threshold to transport. Stand also contends that it is unclear why Atmos-Ky. or the Commission has not lowered the volumetric threshold to transport.[136] Stand referred to the record in 2010-00146 as containing evidence that every customer for whom it had provided information in response to Staff data requests

[132] Stand's Brief at 6.

[133] *Id.*

[134] *Id. at* 7.

[135] *Id. at* 8.

[136] *Id.*

had saved money compared with what it would have been charged by its LDC.[137] It suggests that the fact that the 30 customers who qualify for transportation service choose to stay on sales service indicates a lack of information available to Atmos-Ky. customers regarding transportation tariff options and the relative costs and benefits of sales versus transportation service.[138]

In response to Stand's argument regarding the Issue of the volumetric eligibility threshold for transportation service, Atmos-Ky. states that Stand provided no evidence supporting its recommendation to reduce the threshold from 9,000 to 3,000 Mcf per year, and that it provided only broad generalization concerning the issue.[139] Atmos-Ky. argues, in response to Stand's uncertainty as to why the Commission has not lowered its volumetric threshold for transportation service, that the reason is the lack of demand from customers for a lower threshold and that the Commission has no basis to arbitrarily impose a reduction. Atmos-Ky. submits that it is a lack of interest and economic benefit that causes sales customers otherwise eligible for transportation service to remain sales customers, and not a lack of information, as Stand claims.[140] Atmos-Ky. states the Commission should not accept Stand's apparent assumption that customers are incapable of obtaining information and making informed judgments.[141]

---

[137] *Id.* at 9.

[138] *Id.* at 11.

[139] Atmos-Ky.'s reply brief at 4.

[140] *Id.*

[141] *Id.*

The information in the record in this case reflects a meaningful effort to address the Commission's directive in Case No. 2010-00146 that gas transportation thresholds be examined in each LDC's next rate case. We find that the exploration of Atmos-Ky.'s gas transportation services and issues surrounding the availability of such service to more customers satisfies the intent of our Order in that case. There is nothing in the record of this proceeding to indicate that sales customers are disadvantaged by Atmos-Ky.'s decision to maintain its existing 9,000 Mcf per year transportation threshold. In the almost 10 months that this rate case has been before the Commission, no customer filed comments in opposition to Atmos-Ky's existing 9,000 Mcf per year transportation threshold and no customer requested to intervene to challenge that threshold level. Atmos-Ky.'s volumetric threshold is not the lowest among Kentucky LDCs, nor is it the highest. The Commission will continue to monitor the issue of transportation thresholds in future base-rate proceedings, and Atmos-Ky. should anticipate further inquiry regarding sales customers' expressions of interest in transportation service.

OTHER ISSUES

Stand's Allegations

Stand alleged in its post-hearing brief that it has been denied due process in this matter on two grounds: 1) the Commission did not have the authority to limit the scope of Stand's intervention to the issue of Atmos-Ky.'s threshold for transportation service; and 2) Stand was denied the right to participate in discovery due to the timing of our Order granting intervention. We will address each of these allegations separately.

The Commission finds that the only person with a statutory right to intervene is the AG, pursuant to KRS 367.150(8)(b). Intervention by all others is permissive and is

within the sound discretion of the Commission. In the unreported case of EnviroPower, LLC v. Public Service Commission of Kentucky, No. 2005-CA-001792-MR, 2007 WL 289328 (Ky. App. Feb. 2, 2007), the Court of Appeals ruled that this Commission retains power in its discretion to grant or deny a motion for intervention, but that discretion is not unlimited. The Court enumerated the statutory and regulatory limits on Commission discretion in ruling on motions to intervene. The statutory limitation, KRS 278.040(2), requires that the person seeking intervention have an interest in the rates or service of a utility, as those are the only two subjects under the jurisdiction of the Commission.

The issues presented in EnviroPower are analogous to the instant case with regard to Commission discretion in granting intervention.[142] Similar to EnviroPower's interest as a competitor in East Kentucky Power Company's ("EKPC") construction of a coal-fired generating plant, Stand's interest as a private natural gas marketer arguably places it in direct competition with Atmos-Ky. in its role as provider of the natural gas commodity to its sales customers. EnviroPower was neither a ratepayer of EKPC nor did it represent a ratepayer of EKPC. Stand is likewise not a ratepayer of Atmos-Ky. nor does it represent a ratepayer in this proceeding.

[142] In *EnviroPower*, East Kentucky Power Cooperative Inc. ("EKPC") applied for a Certificate of Public Convenience and Necessity ("CPCN") to self-construct a 278-MW coal-fired generating plant at its Spurlock Station site in Maysville, Kentucky. Before making its application for a CPCN, EKPC had issued a "Request for Proposals" for various contractors to bid on supplying the necessary power. EnviroPower was one of 39 unsuccessful bidders. The Commission denied EnviroPower's request to intervene upon finding that it was not a ratepayer of EKPC, but a rejected bidder whose interests were not identical to ratepayers'; and that EnviroPower had a legal duty to its members to maximize profits; a far different goal from the protection of ratepayers. Although intervention was denied, EnviroPower was added to the service list so that it could monitor the proceedings, submit further information and comment upon the issues and in fact it filed extensive comments in the form of prepared testimony.

It is only because of an assurance made by the Commission in Case No. 2010-00146, An Investigation of Natural Gas Retail Competition Programs,[143] that Stand was granted intervenor status in this matter. The Commission, in its final report to the Kentucky General Assembly in Case No. 2010-00146, states, "The Commission believes that existing transportation thresholds bear further examination, and the Commission will evaluate each LDC's tariffs and rate design in each LDC's next general rate proceeding."[144] As this is Atmos-Ky.'s first general rate proceeding following the Commission's report, and consistent with the report, Stand was granted intervention in the current matter but its intervention was limited "to participation on the issues of Atmos Energy's transportation threshold levels and any other matters related thereto, but not to whether a Pilot Program for Schools or enhanced Standards of Conduct should be added." The Commission disagrees with Stand's argument that it should have been allowed to explore these other topics in the present case. We find both topics to be extraneous to our consideration of either transportation thresholds, as we agreed to consider in our final report in Case No. 2010-00146, or to our consideration of Atmos-Ky.'s application for an adjustment of rates in the present case. Stand contends that an amendment to the Commission's administrative regulations, which removed both the words "limited" and "full" pertaining to intervention, arguably grant Stand, as an intervenor in this case, the right to interject any topic it chooses into a proceeding before the Commission, regardless of either its relevance or applicability to the matter at hand.

---

[143] Case No. 2010-00146, *An Investigation of Natural Gas Retail Competition Programs* (Ky. PSC Dec. 28, 2010).

[144] *Id.* at 23.

We find this position to be erroneous. Neither the Commission's former regulation pertaining to intervention,[145] nor as it was amended in 2013,[146] bestow upon any intervenor the right to introduce tangential issues into Commission proceedings, as Stand has attempted to do in this matter regarding a pilot program for Kentucky's school facilities and regarding its promotion of Commission-imposed Standards of Conduct against Atmos-Ky. Further, the prior provision in our regulations allowing for "limited intervention" had nothing to do with limiting the issues that could be addressed by an intervenor. Rather, the limitation in "limited intervention" extended only to the documents that other parties had to serve on the limited intervenor and the exclusion of the limited intervenor as a designated party for purposes of rehearing or judicial review.

Stand maintains that it was denied due process because the Commission did not rule on its motion to intervene for more than three months and then after the closure of discovery. The Commission finds Stand's position without merit on two separate grounds. First, 807 KAR 5:001, Section 4(11)(d), the amended regulation regarding intervention which Stand earlier touts, states, "Unless the commission finds good cause to order otherwise, a person granted leave to intervene in a case shall, as a condition of his intervention, be subject to the procedural schedule in existence in that case when the order granting the person's intervention is issued." Although Stand would seem to imply otherwise, there is nothing in this provision that conditions its applicability on when intervention is granted by the Commission. In addition, there is nothing in the record to indicate any effort by Stand to seek amendment of the procedural schedule in place at

[145] 807 KAR 5:001, Section 3(8).

[146] 807 KAR 5:001, Section 4(11).

the time it was granted intervention. The initial language, "Unless the commission finds good cause to order otherwise. . ." would allow the Commission to amend the procedural schedule if "good cause" exists, but Stand never made such a request or brought its concern to the Commission while the evidentiary record was open. In fact, Stand never raised the claim of a denial to participate in discovery until it filed its post-hearing brief, which was over six months after it was granted intervention. Thus,its recent claim that it was denied due process is unconvincing.

The Commission also finds Stand's claim that it was denied the opportunity to participate in discovery disingenuous on a second level. At the time Stand was granted intervention on September 3, 2013, the only discovery deadline that had passed was the request for information to Atmos-Ky. due on August 14, 2013, to which Atmos-Ky. responded on August 28, 2013. After the Commission's September 3, 2013 Order granting its intervention, Stand had the opportunity to file supplemental requests for information to Atmos-Ky. by September 11, 2013; to file intervenor testimony by October 9, 2013; and to file requests for information to the AG by October 23, 2013. Stand had each of these opportunities as part of the original procedural schedule, which it accepted as a condition of its intervention,[147] and did not request be amended.

Stand's participation in this case has been minimal. Following the filing of its motion to intervene and memorandum in support of its motion, which primarily advocated that Atmos-Ky. be required to implement a pilot program for Kentucky School

[147] 807 KAR 5:001, Section 4(11)(d).

Facilities[148] and that the Commission impose Standards of Conduct against Kentucky gas utilities with unregulated gas marketing affiliates,[149] both issues that are outside the scope of these proceedings, its participation has consisted of briefly questioning two of Atmos-Ky.'s ten witnesses at the January 23, 2014 hearing, each for less than five minutes,[150] and filing a post-hearing brief.[151]

Stand did not request that the procedural schedule be amended; did not file supplemental requests for information to Atmos-Ky.; did not request information from the other intervenor; did not file testimony on its own behalf or present any witnesses at the January 23, 2014 hearing; did not question eight of Atmos-Ky.'s ten witnesses who testified at the January 23, 2014 hearing; and did not question either of the Attorney General's two witnesses who testified at the January 23, 2014 hearing.

In summary, we find that Stand's choices regarding its level of participation in this case create no substantive or procedural due process violations by the Commission.

Depreciation Study

Atmos-Ky.'s depreciation rate study filed as part of its application[152] is the first depreciation rate study filed by Atmos-Ky. since its 2006 general rate case.[153] Based

---

[148] Memorandum Supporting Motion of Stand Energy Corporation to Intervene at pp.5-6.

[149] *Id.* at 7.

[150] Cross-Examination of Mark Martin at 11:17:35–11:20:00 and Cross-Examination of Gary Smith at 5:59:41–6:04:21, January 23, 2014 hearing.

[151] By Order issued March 7, 2014, the Commission granted Stand's e-mail request for additional time to file a post hearing brief.

[152] Direct Testimony of Dane A. Watson.

[153] Case No. 2006-00464, *Application of Atmos Energy Corporation for an Adjustment of Rates* (Ky. PSC July 31, 2007).

on the current study's results, Atmos-Ky. proposed new depreciation rates that would increase its annual depreciation expense by approximately $1.1 million.

The Commission finds that Atmos-Ky.'s proposed depreciation rates are reasonable and should be approved for use by Atmos-Ky. on and after the effective date of the gas service rates approved herein. The Commission also finds that Atmos-Ky. should prepare a new depreciation rate study for Commission review by the earlier of five years from the date of this Order or the filing of Atmos-Ky.'s next application for an adjustment in its base rates.

Wireless Meter Reading

Atmos-Ky.'s application indicated that in fiscal year 2014 it would undertake a Wireless Meter Reading ("WMR") project.[154] It intends to install 20,000 WMR devices in areas where (1) it currently uses contract meter readers, (2) it expects to experience workforce reductions due to retirements and relocations, and (3) meter reading is costly due to the time required for individual reads.[155] While Atmos-Ky. does not expect significant savings in the near term, it indicates that, over time, company meter readers would be trained for other positions that become vacant due to retirements and would fill those positions, resulting in an overall reduction in the required number of operational employees.[156]

Although Atmos-Ky. did not reflect any decrease in expenses during the test year due to the WMR project, but expects to realize savings from the project in the long term.

---

[154] Direct Testimony of Ernest B. Napier at 13.

[155] *Id.*

[156] *Id.* at 14.

The Commission is interested in the level of savings Atmos-Ky. will realize as a result of the WMR project on a long-term term basis. Accordingly, in conjunction with its next general rate application, we find that Atmos-Ky. should submit an analysis of the costs incurred and savings realized because of the WMR project from its inception to a date within 90 days of the submission of the rate application.

SUMMARY

The Commission, after consideration of the evidence of record and being otherwise sufficiently advised, finds that:

1. The rates set forth in the Appendix to this Order are the fair, just, and reasonable rates for Atmos-Ky. to charge for service rendered on and after January 24, 2014.

2. The rate of return granted herein is fair, just, and reasonable and will provide sufficient revenue for Atmos-Ky. to meet its financial obligations with a reasonable amount remaining for equity growth.

3. The rates proposed by Atmos-Ky. would produce revenue in excess of that found reasonable herein and should be denied.

4. Atmos-Ky.'s proposal to implement new depreciation rates based on the depreciation study it filed in this proceeding should be granted with the new depreciation rates to be effective as of the effective date of the gas service rates approved herein.

5. Atmos-Ky. should file a new depreciation study for Commission review by the earlier of five years from the date of this Order or the filing of its next general rate application.

6. The proposed MLR and SDR tariffs are not currently warranted and should be denied.

7. The proposed Door Tag Fee is not reasonable and should be denied.

8. Atmos-Ky.'s request for permanent approval of its WNA tariff and the proposed language concerning NOAA's 30-year normal for the period ending 2010, which should be updated with each base-rate proceeding, is reasonable and should be approved.

9. Atmos-Ky.'s proposal to revise its G-1 and G-2 sales tariffs to permit the resale of natural gas as a motor vehicle fuel is reasonable and should be approved

10. All other tariff modifications proposed by Atmos-Ky. or agreed to by Atmos-Ky. through the discovery process in this proceeding are reasonable and should be approved.

11. As part of its next application for an adjustment of its base rates for gas service, Atmos-Ky. should submit the IRS private-letter ruling required herein, and should defer the related cost in a regulatory asset account to be addressed in that rate proceeding.

12. As part of its next application for an adjustment of its base rates for gas service, Atmos-Ky. should submit the comparison required herein of weather-normalization methodologies along with support for the time period it proposes to use to normalize revenues, including the superiority of the chosen method in terms of its predictive value for future temperatures.

13. As part of its next application for an adjustment of its base rates for gas service, Atmos-Ky. should submit the results of its analyses required herein on the

threat of bypass posed by its special contract customers and on the sufficiency of the revenue generated by these customers to continue to cover variable cost and make a contribution to fixed cost.

14. As part of its next application for an adjustment of its base rates for gas service, Atmos-Ky. should submit an analysis of the costs incurred and savings realized due to the WMR project from its inception to a date within 90 days of the submission of the rate application.

15. As part of its next application for an adjustment of its base rates for gas service, Atmos-Ky. should submit multiple-methodology COSSes in order to give the Commission a range of reasonable results for use in determining rate design.

16. Future COSSes filed by any party should show separately each of the typical individual COSS steps of functionalization, classification, and allocation.

17. The record in this proceeding regarding Atmos-Ky.'s gas transportation services and issues surrounding the availability of such service satisfies the intent of our Order in Case No. 2010-00146.

IT IS THEREFORE ORDERED that:

1. The rates and charges proposed by Atmos-Ky. are denied.

2. The rates in the appendix to this Order are approved for service rendered by Atmos-Ky. on and after January 24, 2014.

3. The depreciation rates proposed by Atmos-Ky. are approved.

4. Atmos-Ky. shall submit a new depreciation study for Commission review by the earlier of five years from the date of this Order or the filing of its next general rate case.

5. Within 20 days of the date of this Order, Atmos-Ky. shall file with the Commission, using the Commission's Electronic Tariff Filing System, new tariff sheets setting forth the rates, charges, and revisions approved herein and reflecting their effective date and that they were authorized by this Order.

6. Within 60 days from the date of this Order, Atmos-Ky. shall refund with interest all amounts collected for service rendered from January 24, 2014, through the date of this Order that are in excess of the rates set out in the appendix to this Order. The amount refunded to each customer shall equal the amount paid by each customer during the refund period in excess of the rates approved herein.

7. Atmos-Ky. shall pay interest on the refunded amounts at the average of the 3-Month Commercial Paper Rate as reported in the Federal Reserve Bulletin and the Federal Reserve Statistical Release on the date of this Order.

8. Within 75 days from the date of this Order, Atmos-Ky. shall submit a written report to the Commission in which it describes its efforts to refund all monies collected in excess of the rates that are set forth in the appendix to this Order.

9. Any documents filed pursuant to ordering paragraph 8 of this Order shall reference the number of this case and shall be retained in the utility's post case reference file.

10. Atmos-Ky.'s next application for an increase in its base rates shall contain the information required in finding paragraphs 11 through 14.

By the Commission

ENTERED

APR 22 2014

KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2013-00148 DATED APR 22 2014

The following rates and charges are prescribed for the customers served by Atmos Energy Corporation. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

RATE G-1
GENERAL FIRM SALES SERVICE

Base Charge

$16.00	per meter per month for residential service
$40.00	per meter per month for non-residential service

Distribution Charge

First	300	Mcf	$ 1.3180 per Mcf
Next	14,700	Mcf	$ .8800 per Mcf
Over	15,000	Mcf	$ .6200 per Mcf

RATE G-2
INTERRUPTIBLE SALES SERVICE

Base Charge

$350.00	per delivery point per month

Distribution Charge

First	15,000	Mcf	$ .7900 per Mcf
Over	15,000	Mcf	$ .5300 per Mcf

RATE T-3
INTERRUPTIBLE TRANSPORTATION SERVICE

Base Charge

$350.00 per delivery point per month

Distribution Charge for Interruptible Service

First	15,000	Mcf	$ .7900 per Mcf
Over	15,000	Mcf	$ .5300 per Mcf

RATE T-4
FIRM TRANSPORTATON SERVICE

Base Charge

$350.00 per delivery point per month

Distribution Charge for Firm Service

First	300	Mcf	$ 1.3180 per Mcf
Next	14,700	Mcf	$ .8800 per Mcf
Over	15,000	Mcf	$ .6200 per Mcf

Honorable John M Dosker
General Counsel
Stand Energy Corporation
1077 Celestial Street
Building 3, Suite 110
Cincinnati, OHIO 45202-1629

Douglas Walther
5430 LBJ Freeway
1800 Three Lincoln Centre
Dallas, TEXAS 75240

Gregory T Dutton
Assistant Attorney General
Office of the Attorney General Utility & Rate
1024 Capital Center Drive
Suite 200
Frankfort, KENTUCKY 40601-8204

Eric Wilen
Project Manager-Rates & Regulatory Affairs
Atmos Energy Corporation
5420 LBJ Freeway, Suite 1629
Dallas, TEXAS 75420

Jennifer Black Hans
Assistant Attorney General
Office of the Attorney General Utility & Rate
1024 Capital Center Drive
Suite 200
Frankfort, KENTUCKY 40601-8204

Honorable Dennis G Howard II
Assistant Attorney General
Office of the Attorney General Utility & Rate
1024 Capital Center Drive
Suite 200
Frankfort, KENTUCKY 40601-8204

Honorable John N Hughes
Attorney at Law
124 West Todd Street
Frankfort, KENTUCKY 40601

Mark R Hutchinson
Wilson, Hutchinson & Poteat
611 Frederica Street
Owensboro, KENTUCKY 42301

Heather Napier
Office of the Attorney General Utility & Rate
1024 Capital Center Drive
Suite 200
Frankfort, KENTUCKY 40601-8204

Power of Attorney

Form **2848**
(Rev. July 2014)
Department of the Treasury
Internal Revenue Service

Power of Attorney and Declaration of Representative

▶ Information about Form 2848 and its instructions is at *www.irs.gov/form2848.*

OMB No. 1545-0150

For IRS Use Only
Received by.
Name
Telephone
Function
Date / /

Part I **Power of Attorney**

Caution: *A separate Form 2848 must be completed for each taxpayer. Form 2848 will not be honored for any purpose other than representation before the IRS.*

1 **Taxpayer information.** Taxpayer must sign and date this form on page 2, line 7.

Taxpayer name and address	Taxpayer identification number(s)	
Atmos Energy Corporation Three Lincoln Center, Suite 1800 5430 LBJ Freeway Dallas, Texas 75240	75-1743247	
	Daytime telephone number (972) 934-9227	Plan number (if applicable)

hereby appoints the following representative(s) as attorney(s)-in-fact:

2 **Representative(s)** must sign and date this form on page 2, Part II.

Name and address	
James I. Warren Miller & Chevalier Chartered 655 Fifteenth St., NW, Washington, DC 20005 **Check if to be sent copies of notices and communications** ☒	CAF No. 2000-05860R PTIN Telephone No. 202-626-5959 Fax No. 202-626-5801 Check if new: Address ☐ Telephone No. ☐ Fax No. ☐
Name and address Alexander Zakupowsky, Jr. Miller & Chevalier Chartered 655 Fifteenth St., NW, Washington, DC 20005 **Check if to be sent copies of notices and communications** ☐	CAF No. 5005-91220R PTIN Telephone No. 202-626-5950 Fax No. 202-626-5801 Check if new: Address ☐ Telephone No. ☐ Fax No. ☐
Name and address **(Note.** IRS sends notices and communications to only two representatives.)	CAF No. PTIN Telephone No. Fax No. Check if new: Address ☐ Telephone No. ☐ Fax No. ☐
Name and address **(Note.** IRS sends notices and communications to only two representatives.)	CAF No. PTIN Telephone No. Fax No. Check if new: Address ☐ Telephone No. ☐ Fax No. ☐

to represent the taxpayer before the Internal Revenue Service and perform the following acts:

3 **Acts authorized (you are required to complete this line 3).** With the exception of the acts described in line 5b, I authorize my representative(s) to receive and inspect my confidential tax information and to perform acts that I can perform with respect to the tax matters described below. For example, my representative(s) shall have the authority to sign any agreements, consents, or similar documents (see instructions for line 5a for authorizing a representative to sign a return).

Description of Matter (Income, Employment, Payroll, Excise, Estate, Gift, Whistleblower, Practitioner Discipline, PLR, FOIA, Civil Penalty, Sec. 5000A Shared Responsibility Payment, Sec. 4980H Shared Responsibility Payment, etc.) (see instructions)	Tax Form Number (1040, 941, 720, etc.) (if applicable)	Year(s) or Period(s) (if applicable) (see instructions)
PLR Request	1120	2014-2015

4 **Specific use not recorded on Centralized Authorization File (CAF).** If the power of attorney is for a specific use not recorded on CAF, check this box. See the instructions for **Line 4. Specific Use Not Recorded on CAF** ▶ ☐

5a **Additional acts authorized.** In addition to the acts listed on line 3 above, I authorize my representative(s) to perform the following acts (see instructions for line 5a for more information):

☐ Authorize disclosure to third parties; ☐ Substitute or add representative(s); ☐ Sign a return;

☐ Other acts authorized:

b **Specific acts not authorized.** My representative(s) is (are) not authorized to endorse or otherwise negotiate any check (including directing or accepting payment by any means, electronic or otherwise, into an account owned or controlled by the representative(s) or any firm or other entity with whom the representative(s) is (are) associated) issued by the government in respect of a federal tax liability.

List any specific deletions to the acts otherwise authorized in this power of attorney (see instructions for line 5b): _____

6 **Retention/revocation of prior power(s) of attorney.** The filing of this power of attorney automatically revokes all earlier power(s) of attorney on file with the Internal Revenue Service for the same matters and years or periods covered by this document. If you do not want to revoke a prior power of attorney, check here ▶ ☑

YOU MUST ATTACH A COPY OF ANY POWER OF ATTORNEY YOU WANT TO REMAIN IN EFFECT.

7 **Signature of taxpayer.** If a tax matter concerns a year in which a joint return was filed, each spouse must file a separate power of attorney even if they are appointing the same representative(s). If signed by a corporate officer, partner, guardian, tax matters partner, executor, receiver, administrator, or trustee on behalf of the taxpayer, I certify that I have the authority to execute this form on behalf of the taxpayer.

▶ **IF NOT COMPLETED, SIGNED, AND DATED, THE IRS WILL RETURN THIS POWER OF ATTORNEY TO THE TAXPAYER.**

Signature	Date	Title (if applicable)
Pace McDonald	1/7/15	VP-Tax
Print Name		Atmos Energy Corporation Print name of taxpayer from line 1 if other than individual

Part II Declaration of Representative

Under penalties of perjury, by my signature below I declare that:

- I am not currently suspended or disbarred from practice before the Internal Revenue Service;
- I am subject to regulations contained in Circular 230 (31 CFR, Subtitle A, Part 10), as amended, governing practice before the Internal Revenue Service;
- I am authorized to represent the taxpayer identified in Part I for the matter(s) specified there; and
- I am one of the following:

a Attorney—a member in good standing of the bar of the highest court of the jurisdiction shown below.

b Certified Public Accountant—duly qualified to practice as a certified public accountant in the jurisdiction shown below.

c Enrolled Agent—enrolled as an agent by the Internal Revenue Service per the requirements of Circular 230.

d Officer—a bona fide officer of the taxpayer organization.

e Full-Time Employee—a full-time employee of the taxpayer.

f Family Member—a member of the taxpayer's immediate family (for example, spouse, parent, child, grandparent, grandchild, step-parent, step-child, brother, or sister).

g Enrolled Actuary—enrolled as an actuary by the Joint Board for the Enrollment of Actuaries under 29 U.S.C. 1242 (the authority to practice before the Internal Revenue Service is limited by section 10.3(d) of Circular 230).

h Unenrolled Return Preparer—Your authority to practice before the Internal Revenue Service is limited. You must have been eligible to sign the return under examination and have prepared and signed the return. **See Notice 2011-6 and *Special rules for registered tax return preparers and unenrolled return preparers* in the instructions (PTIN required for designation h).**

i Registered Tax Return Preparer—registered as a tax return preparer under the requirements of section 10.4 of Circular 230. Your authority to practice before the Internal Revenue Service is limited. You must have been eligible to sign the return under examination and have prepared and signed the return. See **Notice 2011-6 and *Special rules for registered tax return preparers and unenrolled return preparers* in the instructions (PTIN required for designation i).**

k Student Attorney or CPA—receives permission to represent taxpayers before the IRS by virtue of his/her status as a law, business, or accounting student working in an LITC or STCP. See instructions for Part II for additional information and requirements.

r Enrolled Retirement Plan Agent—enrolled as a retirement plan agent under the requirements of Circular 230 (the authority to practice before the Internal Revenue Service is limited by section 10.3(e)).

▶ **IF THIS DECLARATION OF REPRESENTATIVE IS NOT COMPLETED, SIGNED, AND DATED, THE IRS WILL RETURN THE POWER OF ATTORNEY. REPRESENTATIVES MUST SIGN IN THE ORDER LISTED IN PART I, LINE 2.** See the instructions for Part II.

Note: For designations d-f, enter your title, position, or relationship to the taxpayer in the "Licensing jurisdiction" column. See the instructions for Part II for more information.

Designation—Insert above letter (a–r)	Licensing jurisdiction (state) or other licensing authority (if applicable)	Bar, license, certification, registration, or enrollment number (if applicable). See instructions for Part II for more information.	Signature	Date
a	DC	989415	James M Ware	1/8/15
a	DC	163329	Alexander Schwartzbeck	1-8-15

Form **2848**
(Rev. March 2012)
Department of the Treasury
Internal Revenue Service

Power of Attorney and Declaration of Representative

▶ Type or print. ▶ See the separate instructions.

OMB No. 1545-0150

For IRS Use Only
Received by:
Name
Telephone
Function
Date / /

Part I Power of Attorney

Caution: *A separate Form 2848 should be completed for each taxpayer. Form 2848 will not be honored for any purpose other than representation before the IRS.*

1 Taxpayer information. Taxpayer must sign and date this form on page 2, line 7.

Taxpayer name and address	Taxpayer identification number(s)	
Atmos Energy Holdings, Inc. 5430 LBJ Freeway, Suite 600 Dallas, TX 75240-2601	75-2879833	
	Daytime telephone number 972-855-9951	Plan number (if applicable)

hereby appoints the following representative(s) as attorney(s)-in-fact:

2 Representative(s) must sign and date this form on page 2, Part II.

Name and address		
Jennifer Story 5430 LBJ Freeway, Suite 600 Dallas, TX 75240-2601	CAF No. PTIN Telephone No. 972-855-9905 Fax No. 214-550-5659	
Check if to be sent notices and communications ☑	Check if new: Address ☐	Telephone No. ☐ Fax No. ☐
Name and address Sarah Stojak 5430 LBJ Freeway, Suite 600 Dallas, TX 75240-2601	CAF No. PTIN Telephone No. 972-855-3724 Fax No. 214-550-9209	
Check if to be sent notices and communications ☑	Check if new: Address ☐	Telephone No. ☐ Fax No. ☐
Name and address	CAF No. PTIN Telephone No. Fax No.	
	Check if new: Address ☐	Telephone No. ☐ Fax No. ☐

to represent the taxpayer before the Internal Revenue Service for the following matters:

3 Matters

Description of Matter (Income, Employment, Payroll, Excise, Estate, Gift, Whistleblower, Practitioner Discipline, PLR, FOIA, Civil Penalty, etc.) (see instructions for line 3)	Tax Form Number (1040, 941, 720, etc.) (if applicable)	Year(s) or Period(s) (if applicable) (see instructions for line 3)
Income Tax, Employment, Excise, Civil Penalty	1120, 990, 990-T, 3115, 941, 720	199909-201609

4 Specific use not recorded on Centralized Authorization File (CAF). If the power of attorney is for a specific use not recorded on CAF, check this box. See the instructions for Line 4. Specific Uses Not Recorded on CAF . . . . . ▶ ☐

5 Acts authorized. Unless otherwise provided below, the representatives generally are authorized to receive and inspect confidential tax information and to perform any and all acts that I can perform with respect to the tax matters described on line 3, for example, the authority to sign any agreements, consents, or other documents. The representative(s), however, is (are) not authorized to receive or negotiate any amounts paid to the client in connection with this representation (including refunds by either electronic means or paper checks). Additionally, unless the appropriate box(es) below are checked, the representative(s) is (are) not authorized to execute a request for disclosure of tax returns or return information to a third party, substitute another representative or add additional representatives, or sign certain tax returns.

☐ Disclosure to third parties; ☐ Substitute or add representative(s); ☐ Signing a return;

☐ Other acts authorized:

(see instructions for more information)

Exceptions. An unenrolled return preparer cannot sign any document for a taxpayer and may only represent taxpayers in limited situations. An enrolled actuary may only represent taxpayers to the extent provided in section 10.3(d) of Treasury Department Circular No. 230 (Circular 230). An enrolled retirement plan agent may only represent taxpayers to the extent provided in section 10.3(e) of Circular 230. A registered tax return preparer may only represent taxpayers to the extent provided in section 10.3(f) of Circular 230. See the line 5 instructions for restrictions on tax matters partners. In most cases, the student practitioner's (level k) authority is limited (for example, they may only practice under the supervision of another practitioner).

List any specific deletions to the acts otherwise authorized in this power of attorney:

6 **Retention/revocation of prior power(s) of attorney.** The filing of this power of attorney automatically revokes all earlier power(s) of attorney on file with the Internal Revenue Service for the same matters and years or periods covered by this document. If you do not want to revoke a prior power of attorney, check here . . . . . ▶ ☒
YOU MUST ATTACH A COPY OF ANY POWER OF ATTORNEY YOU WANT TO REMAIN IN EFFECT.

7 **Signature of taxpayer.** If a tax matter concerns a year in which a joint return was filed, the husband and wife must each file a separate power of attorney even if the same representative(s) is (are) being appointed. If signed by a corporate officer, partner, guardian, tax matters partner, executor, receiver, administrator, or trustee on behalf of the taxpayer, I certify that I have the authority to execute this form on behalf of the taxpayer.

▶ **IF NOT SIGNED AND DATED, THIS POWER OF ATTORNEY WILL BE RETURNED TO THE TAXPAYER.**

Signature	Date	Title (if applicable)
	7/25/13	Vice President of Tax

Print Name	PIN Number	Print name of taxpayer from line 1 if other than individual
Pace McDonald	☐☐☐☐☐	Atmos Energy Holdings, Inc.

Part II Declaration of Representative

Under penalties of perjury, I declare that:

- I am not currently under suspension or disbarment from practice before the Internal Revenue Service;
- I am aware of regulations contained in Circular 230 (31 CFR, Part 10), as amended, concerning practice before the Internal Revenue Service;
- I am authorized to represent the taxpayer identified in Part I for the matter(s) specified there; and
- I am one of the following:

a Attorney—a member in good standing of the bar of the highest court of the jurisdiction shown below.

b Certified Public Accountant—duly qualified to practice as a certified public accountant in the jurisdiction shown below.

c Enrolled Agent—enrolled as an agent under the requirements of Circular 230.

d Officer—a bona fide officer of the taxpayer's organization.

e Full-Time Employee—a full-time employee of the taxpayer.

f Family Member—a member of the taxpayer's immediate family (for example, spouse, parent, child, grandparent, grandchild, step-parent, step-child, brother, or sister).

g Enrolled Actuary—enrolled as an actuary by the Joint Board for the Enrollment of Actuaries under 29 U.S.C. 1242 (the authority to practice before the Internal Revenue Service is limited by section 10.3(d) of Circular 230).

h Unenrolled Return Preparer—Your authority to practice before the Internal Revenue Service is limited. You must have been eligible to sign the return under examination and have signed the return. **See Notice 2011-6 and Special rules for registered tax return preparers and unenrolled return preparers in the instructions.**

l Registered Tax Return Preparer—registered as a tax return preparer under the requirements of section 10.4 of Circular 230. Your authority to practice before the Internal Revenue Service is limited. You must have been eligible to sign the return under examination and have signed the return. **See Notice 2011-6 and Special rules for registered tax return preparers and unenrolled return preparers in the instructions.**

k Student Attorney or CPA—receives permission to practice before the IRS by virtue of his/her status as a law, business, or accounting student working in LITC or STCP under section 10.7(d) of Circular 230. See instructions for Part II for additional information and requirements.

r Enrolled Retirement Plan Agent—enrolled as a retirement plan agent under the requirements of Circular 230 (the authority to practice before the Internal Revenue Service is limited by section 10.3(e)).

▶ **IF THIS DECLARATION OF REPRESENTATIVE IS NOT SIGNED AND DATED, THE POWER OF ATTORNEY WILL BE RETURNED. REPRESENTATIVES MUST SIGN IN THE ORDER LISTED IN LINE 2 ABOVE.** See the instructions for Part II.

Note: For designations d-f, enter your title, position, or relationship to the taxpayer in the "Licensing jurisdiction" column. See the instructions for Part II for more information.

Designation—Insert above letter (a–r)	Licensing jurisdiction (state) or other licensing authority (if applicable)	Bar, license, certification, registration, or enrollment number (if applicable). See instructions for Part II for more information.	Signature	Date
e	Director Inc. Tax		Jennifer Davis	7/25/13
e	Manager Inc. Tax		Karen Hoji	7-25-13

Form **2848**
(Rev. March 2012)
Department of the Treasury
Internal Revenue Service

Power of Attorney and Declaration of Representative

► Type or print. ► See the separate instructions.

OMB No. 1545-0150

For IRS Use Only
Received by:
Name
Telephone
Function
Date / /

Part I **Power of Attorney**

Caution: *A separate Form 2848 should be completed for each taxpayer. Form 2848 will not be honored for any purpose other than representation before the IRS.*

1 Taxpayer Information. Taxpayer must sign and date this form on page 2, line 7.

Taxpayer name and address	Taxpayer identification number(s)	
Atmos Energy Corporation, Inc. and Subsidiaries 5430 LBJ Freeway, Suite 600 Dallas, TX 75240-2601	75-1743247 Daytime telephone number 972-855-9951	Plan number (if applicable)

hereby appoints the following representative(s) as attorney(s)-in-fact:

2 Representative(s) must sign and date this form on page 2, Part II.

Name and address	CAF No. / PTIN / Telephone No. / Fax No. / Check if new: Address ☐ Telephone No. ☐ Fax No. ☐
Jennifer Story 5430 LBJ Freeway, Suite 600 Dallas, TX 75240-2601 Check if to be sent notices and communications ☑	CAF No. PTIN Telephone No. 972-855-9905 Fax No. 214-550-5659
Sarah Stojak 5430 LBJ Freeway, Suite 600 Dallas, TX 75240-2601 Check if to be sent notices and communications ☑	CAF No. PTIN Telephone No. 972-855-3724 Fax No. 214-550-9209
Name and address	CAF No. PTIN Telephone No. Fax No.

to represent the taxpayer before the Internal Revenue Service for the following matters:

3 Matters

Description of Matter (Income, Employment, Payroll, Excise, Estate, Gift, Whistleblower, Practitioner Discipline, PLR, FOIA, Civil Penalty, etc.) (see instructions for line 3)	Tax Form Number (1040, 941, 720, etc.) (if applicable)	Year(s) or Period(s) (if applicable) (see instructions for line 3)
Income Tax, Employment, Excise, Civil Penalty	1120, 990, 990-T, 3115, 941, 720	199909-201609

4 Specific use not recorded on Centralized Authorization File (CAF). If the power of attorney is for a specific use not recorded on CAF, check this box. See the instructions for Line 4. **Specific Uses Not Recorded on CAF** . . . . . ► ☐

5 Acts authorized. Unless otherwise provided below, the representatives generally are authorized to receive and inspect confidential tax information and to perform any and all acts that I can perform with respect to the tax matters described on line 3, for example, the authority to sign any agreements, consents, or other documents. The representative(s), however, is (are) not authorized to receive or negotiate any amounts paid to the client in connection with this representation (including refunds by either electronic means or paper checks). Additionally, unless the appropriate box(es) below are checked, the representative(s) is (are) not authorized to execute a request for disclosure of tax returns or return information to a third party, substitute another representative or add additional representatives, or sign certain tax returns.

☐ Disclosure to third parties; ☐ Substitute or add representative(s); ☐ Signing a return;

☐ Other acts authorized:

(see instructions for more information)

Exceptions. An unenrolled return preparer cannot sign any document for a taxpayer and may only represent taxpayers in limited situations. An enrolled actuary may only represent taxpayers to the extent provid d in section 10.3(d) of Treasury Department Circular No. 230 (Circular 230). An enrolled retirement plan agent may only represent taxpayers to the extent provided in section 10.3(e) of Circular 230. A registered tax return preparer may only represent taxpayers to the extent provided in section 10.3(f) of Circular 230. See the line 5 instructions for restrictions on tax matters partners. In most cases, the student practitioner's (level k) authority is limited (for example, they may only practice under the supervision of another practitioner).

List any specific deletions to the acts otherwise authorized in this power of attorney:

6 **Retention/revocation of prior power(s) of attorney.** The filing of this power of attorney automatically revokes all earlier power(s) of attorney on file with the Internal Revenue Service for the same matters and years or periods covered by this document. If you do not want to revoke a prior power of attorney, check here . . . . . ▶ ☒
YOU MUST ATTACH A COPY OF ANY POWER OF ATTORNEY YOU WANT TO REMAIN IN EFFECT.

7 **Signature of taxpayer.** If a tax matter concerns a year in which a joint return was filed, the husband and wife must each file a separate power of attorney even if the same representative(s) is (are) being appointed. If signed by a corporate officer, partner, guardian, tax matters partner, executor, receiver, administrator, or trustee on behalf of the taxpayer, I certify that I have the authority to execute this form on behalf of the taxpayer.

▶ **IF NOT SIGNED AND DATED, THIS POWER OF ATTORNEY WILL BE RETURNED TO THE TAXPAYER.**

Signature	Date	Title (if applicable)
	7/25/13	Vice President of Tax

Print Name	PIN Number	Print name of taxpayer from line 1 if other than individual
Pace McDonald	☐☐☐☐☐	Atmos Energy Corporation, Inc. and Subsidiaries

Part II Declaration of Representative

Under penalties of perjury, I declare that:

- I am not currently under suspension or disbarment from practice before the Internal Revenue Service;
- I am aware of regulations contained in Circular 230 (31 CFR, Part 10), as amended, concerning practice before the Internal Revenue Service;
- I am authorized to represent the taxpayer identified in Part I for the matter(s) specified there; and
- I am one of the following:

a Attorney—a member in good standing of the bar of the highest court of the jurisdiction shown below.

b Certified Public Accountant—duly qualified to practice as a certified public accountant in the jurisdiction shown below.

c Enrolled Agent—enrolled as an agent under the requirements of Circular 230.

d Officer—a bona fide officer of the taxpayer's organization.

e Full-Time Employee—a full-time employee of the taxpayer.

f Family Member—a member of the taxpayer's immediate family (for example, spouse, parent, child, grandparent, grandchild, step-parent, step-child, brother, or sister).

g Enrolled Actuary—enrolled as an actuary by the Joint Board for the Enrollment of Actuaries under 29 U.S.C. 1242 (the authority to practice before the Internal Revenue Service is limited by section 10.3(d) of Circular 230).

h Unenrolled Return Preparer—Your authority to practice before the Internal Revenue Service is limited. You must have been eligible to sign the return under examination and have signed the return. **See Notice 2011-6 and Special rules for registered tax return preparers and unenrolled return preparers in the instructions.**

i Registered Tax Return Preparer—registered as a tax return preparer under the requirements of section 10.4 of Circular 230. Your authority to practice before the Internal Revenue Service is limited. You must have been eligible to sign the return under examination and have signed the return. **See Notice 2011-6 and Special rules for registered tax return preparers and unenrolled return preparers in the instructions.**

k Student Attorney or CPA—receives permission to practice before the IRS by virtue of his/her status as a law, business, or accounting student working in LITC or STCP under section 10.7(d) of Circular 230. See instructions for Part II for additional information and requirements.

r Enrolled Retirement Plan Agent—enrolled as a retirement plan agent under the requirements of Circular 230 (the authority to practice before the Internal Revenue Service is limited by section 10.3(e)).

▶ **IF THIS DECLARATION OF REPRESENTATIVE IS NOT SIGNED AND DATED, THE POWER OF ATTORNEY WILL BE RETURNED. REPRESENTATIVES MUST SIGN IN THE ORDER LISTED IN LINE 2 ABOVE.** See the instructions for Part II.

Note: For designations d-f, enter your title, position, or relationship to the taxpayer in the "Licensing jurisdiction" column. See the instructions for Part II for more information.

Designation—Insert above letter (a-r)	Licensing jurisdiction (state) or other licensing authority (if applicable)	Bar, license, certification, registration, or enrollment number (if applicable). See instructions for Part II for more information.	Signature	Date
e	Director Inc. Tax		Jennifer Story	7/25/13
e	Manager Inc. Tax		Sarah Hogue	7-25-13

Form **2848**
(Rev. July 2014)
Department of the Treasury
Internal Revenue Service

Power of Attorney and Declaration of Representative

▶ Information about Form 2848 and its instructions is at *www.irs.gov/form2848.*

OMB No. 1545-0150

For IRS Use Only
Received by:
Name
Telephone
Function
Date / /

Part I Power of Attorney

Caution: *A separate Form 2848 must be completed for each taxpayer. Form 2848 will not be honored for any purpose other than representation before the IRS.*

1 Taxpayer information. Taxpayer must sign and date this form on page 2, line 7.

Taxpayer name and address	Taxpayer identification number(s)	
Atmos Energy Corporation, Inc.and Subsidiaries **5430 LBJ Freeway, Suite 600** **Dallas, TX 75240-2601**	**75-1743247**	
	Daytime telephone number **972-855-9746**	Plan number (if applicable)

hereby appoints the following representative(s) as attorney(s)-in-fact:

2 Representative(s) must sign and date this form on page 2, Part II.

Name and address	
Danielle Renfro **5430 LBJ Freeway, Suite 600** **Dallas, TX 75240-2601**	CAF No. PTIN Telephone No. **972/855-9732** Fax No. **214-550-5717**
Check if to be sent copies of notices and communications ☑	Check if new: Address ☐ Telephone No. ☐ Fax No. ☐
Name and address	
Julie Formanek **5430 LBJ Freeway , Ste 600** **Dallas, TX 75240-2601**	CAF No. **2006-07328R** PTIN Telephone No. **972/855-9746** Fax No. **214-550-5714**
Check if to be sent copies of notices and communications ☐	Check if new: Address ☐ Telephone No. ☐ Fax No. ☑
Name and address	
(Note. IRS sends notices and communications to only two representatives.)	CAF No. PTIN Telephone No. Fax No. Check if new: Address ☐ Telephone No. ☐ Fax No. ☐
Name and address	
(Note. IRS sends notices and communications to only two representatives.)	CAF No. PTIN Telephone No. Fax No. Check if new: Address ☐ Telephone No. ☐ Fax No. ☐

to represent the taxpayer before the Internal Revenue Service and perform the following acts:

3 Acts authorized (you are required to complete this line 3). With the exception of the acts described in line 5b, I authorize my representative(s) to receive and inspect my confidential tax information and to perform acts that I can perform with respect to the tax matters described below. For example, my representative(s) shall have the authority to sign any agreements, consents, or similar documents (see instructions for line 5a for authorizing a representative to sign a return).

Description of Matter (Income, Employment, Payroll, Excise, Estate, Gift, Whistleblower, Practitioner Discipline, PLR, FOIA, Civil Penalty, Sec. 5000A Shared Responsibility Payment, Sec. 4980H Shared Responsibility Payment, etc.) (see instructions)	Tax Form Number (1040, 941, 720, etc.) (if applicable)	Year(s) or Period(s) (if applicable) (see instructions)
Employment, Payroll	**F940, 941,941C, 941X**	**200609-201609**
Civil Penalties	**na**	**200609-201609**

4 Specific use not recorded on Centralized Authorization File (CAF). If the power of attorney is for a specific use not recorded on CAF, check this box. See the instructions for **Line 4. Specific Use Not Recorded on CAF** . . . . . ▶ ☐

5a Additional acts authorized. In addition to the acts listed on line 3 above, I authorize my representative(s) to perform the following acts (see instructions for line 5a for more information):

☐ Authorize disclosure to third parties; ☐ Substitute or add representative(s); ☐ Sign a return; _____

☐ Other acts authorized: _____

b **Specific acts not authorized.** My representative(s) is (are) not authorized to endorse or otherwise negotiate any check (including directing or accepting payment by any means, electronic or otherwise, into an account owned or controlled by the representative(s) or any firm or other entity with whom the representative(s) is (are) associated) issued by the government in respect of a federal tax liability.
List any specific deletions to the acts otherwise authorized in this power of attorney (see instructions for line 5b): _____

6 **Retention/revocation of prior power(s) of attorney.** The filing of this power of attorney automatically revokes all earlier power(s) of attorney on file with the Internal Revenue Service for the same matters and years or periods covered by this document. If you **do not** want to revoke a prior power of attorney, check here . . . . . ▶ ☐
YOU MUST ATTACH A COPY OF ANY POWER OF ATTORNEY YOU WANT TO REMAIN IN EFFECT.

7 **Signature of taxpayer.** If a tax matter concerns a year in which a joint return was filed, each spouse must file a separate power of attorney even if they are appointing the same representative(s). If signed by a corporate officer, partner, guardian, tax matters partner, executor, receiver, administrator, or trustee on behalf of the taxpayer, I certify that I have the authority to execute this form on behalf of the taxpayer.
▶ IF NOT COMPLETED, SIGNED, AND DATED, THE IRS WILL RETURN THIS POWER OF ATTORNEY TO THE TAXPAYER.

Signature	Date	Title (if applicable)
	1/7/15	VP TAX
Pace McDonald		**Atmos Energy Corporation, Inc.and Subsidiaries**
Print Name		Print name of taxpayer from line 1 if other than individual

Part II Declaration of Representative

Under penalties of perjury, by my signature below I declare that:

- I am not currently suspended or disbarred from practice before the Internal Revenue Service;
- I am subject to regulations contained in Circular 230 (31 CFR, Subtitle A, Part 10), as amended, governing practice before the Internal Revenue Service;
- I am authorized to represent the taxpayer identified in Part I for the matter(s) specified there; and
- I am one of the following:

a Attorney—a member in good standing of the bar of the highest court of the jurisdiction shown below.
b Certified Public Accountant—duly qualified to practice as a certified public accountant in the jurisdiction shown below.
c Enrolled Agent—enrolled as an agent by the Internal Revenue Service per the requirements of Circular 230.
d Officer—a bona fide officer of the taxpayer organization.
e Full-Time Employee—a full-time employee of the taxpayer.
f Family Member—a member of the taxpayer's immediate family (for example, spouse, parent, child, grandparent, grandchild, step-parent, step-child, brother, or sister).
g Enrolled Actuary—enrolled as an actuary by the Joint Board for the Enrollment of Actuaries under 29 U.S.C. 1242 (the authority to practice before the Internal Revenue Service is limited by section 10.3(d) of Circular 230).
h Unenrolled Return Preparer—Your authority to practice before the Internal Revenue Service is limited. You must have been eligible to sign the return under examination and have prepared and signed the return. **See Notice 2011-6 and *Special rules for registered tax return preparers and unenrolled return preparers* in the instructions (PTIN required for designation h).**
i Registered Tax Return Preparer—registered as a tax return preparer under the requirements of section 10.4 of Circular 230. Your authority to practice before the Internal Revenue Service is limited. You must have been eligible to sign the return under examination and have prepared and signed the return. **See Notice 2011-6 and *Special rules for registered tax return preparers and unenrolled return preparers* in the instructions (PTIN required for designation i).**
k Student Attorney or CPA—receives permission to represent taxpayers before the IRS by virtue of his/her status as a law, business, or accounting student working in an LITC or STCP. See instructions for Part II for additional information and requirements.
r Enrolled Retirement Plan Agent—enrolled as a retirement plan agent under the requirements of Circular 230 (the authority to practice before the Internal Revenue Service is limited by section 10.3(e)).

▶ IF THIS DECLARATION OF REPRESENTATIVE IS NOT COMPLETED, SIGNED, AND DATED, THE IRS WILL RETURN THE POWER OF ATTORNEY. REPRESENTATIVES MUST SIGN IN THE ORDER LISTED IN PART I, LINE 2. See the instructions for Part II.

Note. For designations d-f, enter your title, position, or relationship to the taxpayer in the "Licensing jurisdiction" column. See the instructions for Part II for more information.

Designation—Insert above letter (a–r)	Licensing jurisdiction (state) or other licensing authority (if applicable)	Bar, license, certification, registration, or enrollment number (if applicable). See instructions for Part II for more information.	Signature	Date
e	Mgr Payroll		Danielle Renfro	1/7/15
e	Sr Payroll Tax Acct			1/7/15

Form **2848**
(Rev. July 2014)
Department of the Treasury
Internal Revenue Service

Power of Attorney and Declaration of Representative

▶ Information about Form 2848 and its instructions is at *www.irs.gov/form2848.*

OMB No. 1545-0150

For IRS Use Only
Received by:
Name
Telephone
Function
Date / /

Part I Power of Attorney

Caution: *A separate Form 2848 must be completed for each taxpayer. Form 2848 will not be honored for any purpose other than representation before the IRS.*

1 Taxpayer information. Taxpayer must sign and date this form on page 2, line 7.

Taxpayer name and address	Taxpayer identification number(s)	
Atmos Energy Holdings, Inc. **5430 LBJ Freeway, Suite 600** **Dallas, TX 75240-2601**	**75-2879833**	
	Daytime telephone number **972-855-9746**	Plan number (if applicable)

hereby appoints the following representative(s) as attorney(s)-in-fact:

2 Representative(s) must sign and date this form on page 2, Part II.

Name and address	CAF No. / PTIN / Telephone No. / Fax No. / Check if new
Danielle Renfro **5430 LBJ Freeway, Suite 600** **Dallas, TX 75240-2601**	CAF No. PTIN Telephone No. **972/855-9732** Fax No. **214-550-5717**
Check if to be sent copies of notices and communications ☑	Check if new: Address ☐ Telephone No. ☐ Fax No. ☐
Name and address	CAF No. **2006-07328R**
Julie Formanek **5430 LBJ Freeway, Ste 600** **Dallas, TX 75240-2601**	PTIN Telephone No. **972/855-9746** Fax No. **214-550-5714**
Check if to be sent copies of notices and communications ☐	Check if new: Address ☐ Telephone No. ☐ Fax No. ☑
Name and address	CAF No. PTIN Telephone No. Fax No.
(Note. IRS sends notices and communications to only two representatives.)	Check if new: Address ☐ Telephone No. ☐ Fax No. ☐
Name and address	CAF No. PTIN Telephone No. Fax No.
(Note. IRS sends notices and communications to only two representatives.)	Check if new: Address ☐ Telephone No. ☐ Fax No. ☐

to represent the taxpayer before the Internal Revenue Service and perform the following acts:

3 Acts authorized (you are required to complete this line 3). With the exception of the acts described in line 5b, I authorize my representative(s) to receive and inspect my confidential tax information and to perform acts that I can perform with respect to the tax matters described below. For example, my representative(s) shall have the authority to sign any agreements, consents, or similar documents (see instructions for line 5a for authorizing a representative to sign a return).

Description of Matter (Income, Employment, Payroll, Excise, Estate, Gift, Whistleblower, Practitioner Discipline, PLR, FOIA, Civil Penalty, Sec. 5000A Shared Responsibility Payment, Sec. 4980H Shared Responsibility Payment, etc.) (see instructions)	Tax Form Number (1040, 941, 720, etc.) (if applicable)	Year(s) or Period(s) (if applicable) (see instructions)
Employment, Payroll	F940, 941,941C, 941X	200609-201609
Civil Penalties	na	200609-201609

4 Specific use not recorded on Centralized Authorization File (CAF). If the power of attorney is for a specific use not recorded on CAF, check this box. See the instructions for **Line 4. Specific Use Not Recorded on CAF** . . . . . ▶ ☐

5a Additional acts authorized. In addition to the acts listed on line 3 above, I authorize my representative(s) to perform the following acts (see instructions for line 5a for more information):

☐ Authorize disclosure to third parties; ☐ Substitute or add representative(s); ☐ Sign a return;

☐ Other acts authorized:

b **Specific acts not authorized.** My representative(s) is (are) not authorized to endorse or otherwise negotiate any check (including directing or accepting payment by any means, electronic or otherwise, into an account owned or controlled by the representative(s) or any firm or other entity with whom the representative(s) is (are) associated) issued by the government in respect of a federal tax liability.
List any specific deletions to the acts otherwise authorized in this power of attorney (see instructions for line 5b): _____

6 **Retention/revocation of prior power(s) of attorney.** The filing of this power of attorney automatically revokes all earlier power(s) of attorney on file with the Internal Revenue Service for the same matters and years or periods covered by this document. If you do not want to revoke a prior power of attorney, check here . . . . . ▶ ☐
YOU MUST ATTACH A COPY OF ANY POWER OF ATTORNEY YOU WANT TO REMAIN IN EFFECT.

7 **Signature of taxpayer.** If a tax matter concerns a year in which a joint return was filed, each spouse must file a separate power of attorney even if they are appointing the same representative(s). If signed by a corporate officer, partner, guardian, tax matters partner, executor, receiver, administrator, or trustee on behalf of the taxpayer, I certify that I have the authority to execute this form on behalf of the taxpayer.
▶ IF NOT COMPLETED, SIGNED, AND DATED, THE IRS WILL RETURN THIS POWER OF ATTORNEY TO THE TAXPAYER.

Signature	Date	Title (if applicable)
	1/7/15	VP TAX

Print Name	Print name of taxpayer from line 1 if other than individual
Pace McDonald	Atmos Energy Holdings, Inc.

Part II Declaration of Representative

Under penalties of perjury, by my signature below I declare that:

- I am not currently suspended or disbarred from practice before the Internal Revenue Service;
- I am subject to regulations contained in Circular 230 (31 CFR, Subtitle A, Part 10), as amended, governing practice before the Internal Revenue Service;
- I am authorized to represent the taxpayer identified in Part I for the matter(s) specified there; and
- I am one of the following:

a Attorney—a member in good standing of the bar of the highest court of the jurisdiction shown below.
b Certified Public Accountant—duly qualified to practice as a certified public accountant in the jurisdiction shown below.
c Enrolled Agent—enrolled as an agent by the Internal Revenue Service per the requirements of Circular 230.
d Officer—a bona fide officer of the taxpayer organization.
e Full-Time Employee—a full-time employee of the taxpayer.
f Family Member—a member of the taxpayer's immediate family (for example, spouse, parent, child, grandparent, grandchild, step-parent, step-child, brother, or sister).
g Enrolled Actuary—enrolled as an actuary by the Joint Board for the Enrollment of Actuaries under 29 U.S.C. 1242 (the authority to practice before the Internal Revenue Service is limited by section 10.3(d) of Circular 230).
h Unenrolled Return Preparer—Your authority to practice before the Internal Revenue Service is limited. You must have been eligible to sign the return under examination and have prepared and signed the return. **See Notice 2011-6 and *Special rules for registered tax return preparers and unenrolled return preparers* in the instructions (PTIN required for designation h).**
i Registered Tax Return Preparer—registered as a tax return preparer under the requirements of section 10.4 of Circular 230. Your authority to practice before the Internal Revenue Service is limited. You must have been eligible to sign the return under examination and have prepared and signed the return. **See Notice 2011-6 and *Special rules for registered tax return preparers and unenrolled return preparers* in the instructions (PTIN required for designation i).**
k Student Attorney or CPA—receives permission to represent taxpayers before the IRS by virtue of his/her status as a law, business, or accounting student working in an LITC or STCP. See instructions for Part II for additional information and requirements.
r Enrolled Retirement Plan Agent—enrolled as a retirement plan agent under the requirements of Circular 230 (the authority to practice before the Internal Revenue Service is limited by section 10.3(e)).

▶ IF THIS DECLARATION OF REPRESENTATIVE IS NOT COMPLETED, SIGNED, AND DATED, THE IRS WILL RETURN THE POWER OF ATTORNEY. REPRESENTATIVES MUST SIGN IN THE ORDER LISTED IN PART I, LINE 2. See the instructions for Part II.

Note. For designations d-f, enter your title, position, or relationship to the taxpayer in the "Licensing jurisdiction" column. See the instructions for Part II for more information.

Designation—Insert above letter (a–r)	Licensing jurisdiction (state) or other licensing authority (if applicable)	Bar, license, certification, registration, or enrollment number (if applicable). See instructions for Part II for more information.	Signature	Date
e	Mgr Payroll		Danielle Renfro	1/7/15
e	Sr Payroll Tax Acct			1/7/15

State of Tennessee
Department of Labor and Workforce Development
Employer Services Unit
220 French Landing Drive, Floor 3-B
Nashville, Tennessee 37243-1002

DECLARATION OF REPRESENTATIVE

This is to certify that (Representative): Automatic Data Processing, Inc.

Located at: 400 West Covina Blve

City: San Dimas State: CA Zip Code: 91773

Phone: (866) 467-0523 Fax: (909) 394-8217

is authorized to represent (Employer): Atmos Energy Holdings, Inc.

Employer's Federal Employer Identification Number: 752879833 Applied For ☐

Employer's Tennessee Employer Account Number: 05516690 Applied For ☐

before the Tennessee Department of Labor and Workforce Development (TDLWD) for the item(s) checked below:

☑	☐
for completing and filing quarterly Premium and Wage Reports	for benefit charge management*

*Benefit Charge Management includes receiving and responding to any time sensitive request(s) for separation information and notice(s) of claim filed and, responding to any summary of benefits charged. It also includes representation for the purpose of filing appeals and appearance in connection with those appeals before Appeal Boards of the TDLWD.

Summaries of benefits charged are mailed to the primary address of record.

This authorization supersedes all similar authorizations. This form also authorizes the TDLWD to, in accordance with applicable law, release to the Representative any documentation relating to the Employer's account that it could release to the Employer.

Employer Name: Atmos Energy Holdings, Inc.

Trade Name: Atmos Energy Holdings, Inc.

Mailing Address: PO Box Box 650205

Dallas, TX 75265-0205

Required:

Authorized Employer Signature: Date: 01/01/15

Print Name of Signer: Pace McDonald Title: VP-Tax

Return to: Tennessee Department of Labor and Workforce Development
Employer Services Unit
220 French Landing Drive, Floor 3-B
Nashville, TN 37243

Phone: 615-741-2486
Fax: 615-741-7214

State of Tennessee
Department of Labor and Workforce Development
Employer Services Unit
220 French Landing Drive, Floor 3-B
Nashville, Tennessee 37243-1002

DECLARATION OF REPRESENTATIVE

This is to certify that (Representative): Automatic Data Processing, Inc.

Located at: 400 West Covina Blve

City: San Dimas State: CA Zip Code: 91773

Phone: (866) 467-0523 Fax: (909) 394-8217

is authorized to represent (Employer): Atmos Energy Corporation

Employer's Federal Employer Identification Number: 751743247 Applied For ☐

Employer's Tennessee Employer Account Number: 04556994 Applied For ☐

before the Tennessee Department of Labor and Workforce Development (TDLWD) for the item(s) checked below:

☑ for completing and filing quarterly Premium and Wage Reports	☐ for benefit charge management*

*Benefit Charge Management includes receiving and responding to any time sensitive request(s) for separation information and notice(s) of claim filed and, responding to any summary of benefits charged. It also includes representation for the purpose of filing appeals and appearance in connection with those appeals before Appeal Boards of the TDLWD.

Summaries of benefits charged are mailed to the primary address of record.

This authorization supersedes all similar authorizations. This form also authorizes the TDLWD to, in accordance with applicable law, release to the Representative any documentation relating to the Employer's account that it could release to the Employer.

Employer Name: Atmos Energy Corporation

Trade Name: United Cities Gas Co

Mailing Address: PO Box Box 650205

Dallas, TX 75265-0205

Required:

Authorized Employer Signature: [signature] Date: 01/01/15

Print Name of Signer: Paul McDonald Title: VP - Tax

Return to: Tennessee Department of Labor and Workforce Development
Employer Services Unit
220 French Landing Drive, Floor 3-B
Nashville, TN 37243

Phone: 615-741-2486
Fax: 615-741-7214

LB-0927 (Rev. 07-14) RDA 1559

EXHIBIT

B

COMMONWEALTH OF KENTUCKY
OFFICE OF THE ATTORNEY GENERAL

JACK CONWAY
ATTORNEY GENERAL

1024 CAPITAL CENTER DRIVE
SUITE 200
FRANKFORT, KENTUCKY 40601

December 12, 2014

Via electronic mail
Hon. Jeff DeRouen
Executive Director
Public Service Commission
211 Sower Blvd.
Frankfort, KY 40601

RE: Atmos Energy Corporation, Case No. 2013-00148

Dear Mr. DeRouen:

At the request of staff for the Commission and in response to Atmos Energy Corporation's ("Atmos") request for approval of its draft request to the Internal Revenue Service ("IRS") for a Private Letter Ruling ("PLR") on the issue of net operating loss carry-forward ("NOLC"), the Attorney General files the following comments to the draft. Moreover, the Attorney General files this in reply to Atmos' letter of counsel dated December 12, 2014.

As quoted in Atmos' November 7, 2014 cover letter to the Commission, the Final Order in Case No. 2013-00148 requested "a more definitive assessment of [the] issue" regarding NOLC, which was addressed by the Attorney General's expert witness, Bion Ostrander, during the case proceedings. While the Commission did not adopt Mr. Ostrander's proposal, it did order Atmos to request a PLR that would eliminate the ambiguity in the regulations. The draft proposed does not eliminate the ambiguity, but rather requests that the IRS answer two (2) unnecessarily specific questions, which may be summarized as confirmation that there is enough ambiguity in the law to permit Atmos to treat NOLC the way it chose to treat it. As such, the letter as currently drafted does not comport with the Commission's Order.

Rather, the question that should be presented is whether other options for treating the NOLC are reasonable and may be required by the Commission. In other words, the question presented should ask the broader question of whether the IRS requires a specific method to be used. At pages 23 to 29 of the draft letter, Atmos discusses the three (3) options or methodologies: (1) the "last dollars deducted method" (also known as the "with or without" method), (2) the "first dollars deducted" method, and (3) a ratable allocation. However, the rulings requested at page 9 of the draft only ask whether a computation on a "last dollars deducted" method is allowable. The Attorney General posits that the IRS has not cited a specific method, therefore the ratable allocation, for example, is an option that Atmos could utilize were the Commission to direct it to do so. At a minimum, the rulings requested on page 9

of the letter draft should more broadly address all approaches available to the IRS, including but not limited to "the ratable allocation method (and other allocation approaches available to the Service)."

The Attorney General requests that the Commission direct Atmos to consult its tax counsel and draft the letter and the PLR request in a manner that definitively addresses whether Atmos may legally adopt any of the methods referenced and still comply with the requirements of the Internal Revenue Code and Treasury Regulations.

Tendered by:

Jennifer Black Hans
Executive Director

And

Gregory T. Dutton
Assistant Attorney General

Cc: Hon. John N. Hughes
Mark Martin
Richard Raff
Virginia Gregg

EXHIBIT

C

JOHN N. HUGHES
Attorney at Law
Professional Service Corporation
124 West Todd Street
Frankfort, Kentucky 40601

Telephone: (502) 227-7270 Email: jnhughes@fewpb.net

December 12, 2014

Mr. Jeff Derouen
Executive Director
Public Service Commission
211 Sower Blvd.
Frankfort, KY 40601

Re: Atmos Energy Corporation
Case No. 2103-00148

Dear Mr. Derouen:

The Attorney General's email of yesterday related to the Private Letter Ruling (PLR) request of Atmos Energy contains nothing substantive to support its beliefs that the letter is improperly or inadequately drafted. Citing no legal authority or other basis for its contentions, the Attorney General seeks to become a participant in the drafting of the PLR. The Internal Revenue Service (IRS) revenue procedures cited in the November 7, 2014 letter to the Commission from Atmos Energy provide the only procedures for the submission of the PLR. This letter is not a joint or collaborative venture. The request for a ruling, its tone, tenor and substance is exclusively the province of the taxpayer. The opportunity for the AG to comment is specified in the IRS revenue procedures – a letter submitted to the IRS after the PLR has been submitted. The AG has no allowable participation in the drafting, review or submission of the PLR. The role of the Commission is also specified: an acknowledgement that the letter is adequate and complete. That role does not provide an opportunity for the Commission to be a co-author of the letter or to specify the terms of the letter. Even if there is disagreement about the content of the letter, Atmos as the taxpayer has the ultimate responsibility for its content. Given the explicit procedural requirements of the PLR process, the Attorney General's beliefs and opinions on the method of drafting the letter, submission of comments to the Commission and content of the letter are unsupported and unsupportable.

The PLR comports with the Commission's directive in the final order – it seeks a definitive ruling on whether not including net operating loss carryforward (NOLC) would be a normalization violation. Atmos Energy has included a request for determination of the appropriate allocation methodology as well. The PLR mentions all allocation methods and

discusses the merits of them beginning on page 24. It also addresses pitfalls with the ratable allocation approach specifically. (See pages 25-26). The PLR asks for the IRS's conclusion that the "with and without" methodology is the preferable and permissible methodology. Contrary to the AG's assertion, Atmos Energy has not neglected a proper discussion of other methodologies of the appropriate allocation.

Finally, the AG seems to suggest that the request be reworked to allow the IRS to opine that many options are available. Atmos Energy believes that a request crafted as such would not be received favorably by the IRS. Taxpayer ruling requests by definition are to be narrowly crafted and request a specific ruling, not a menu of options. Ruling requests that are broad, offer choices or do not reach a conclusion take longer to complete and can be at risk for getting an inconclusive or ambiguous outcome.

A meeting to discuss these issues is unnecessary and inappropriate. It would only impede the orderly process mandated by the IRS revenue procedures. The AG has no legal basis or authority to deviate from or to modify the Commission's role in the PLR process. Atmos is not opposed to comments by the AG, but those comments should be submitted in accord with the IRS procedures. Even if the AG were to provide the Commission with comments, those comments would not be incorporated into the PLR request. While those comments may inform the Commission of the AG's stance on the letter, they will have no direct impact on the substance of the letter itself. The drafting of the PLR is not a negotiated, mutually agreed to process.

If the Commission determines that it is unable to acknowledge the completeness of the letter as a result of the AG's comments, Atmos would still be obligated to submit the PLR to the IRS pursuant to the final order in this case. The effect of that action likely would result in a conference with the IRS to verify that Atmos has meet the procedural requirements related to the Commission's participation in the process. For these reasons, Atmos Energy submits that the Commission should acknowledge the PLR for adequacy and completeness. Upon submission of the letter to the IRS, the Attorney General will have the ability to submit comments commensurate with the terms of the IRS revenue procedures.

Submitted By:

Mark R. Hutchinson
Wilson, Hutchinson and Poteat
611 Frederica St.
Owensboro, KY 42301
270 926 5011
270-926-9394 fax
randy@whplawfirm.com

And

John N. Hughes
124 West Todd St.
Frankfort, KY 40601
Phone: 502 227 7270
jnhughes@fewpb.net

Attorneys for Atmos Energy Corporation

EXHIBIT

D

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

In the Matter of:

APPLICATION OF ATMOS ENERGY	)	
CORPORATION FOR AN ADJUSTMENT	)	Case No.
OF RATES AND TARIFF MODIFICATIONS	)	2013-00148

SUPPLEMENTAL AND CORRECTED DIRECT TESTIMONY

OF

BION C. OSTRANDER

PUBLIC VERSION

ON BEHALF OF

KENTUCKY OFFICE OF ATTORNEY GENERAL

FILED: NOVEMBER 18, 2013

TABLE OF CONTENTS – OSTRANDER DIRECT TESTIMONY

Summary of Exhibits

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

CASE NO. 2013-00148

SUPPLEMENTAL AND CORRECTED DIRECT TESTIMONY OF

BION C. OSTRANDER

---

1. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Bion C. Ostrander. My business address is 1121 S.W. Chetopa Trail, Topeka, KS 66615-1408.

Q. WHAT IS YOUR OCCUPATION?

A. I am President of Ostrander Consulting. I am an independent regulatory consultant and a Certified Public Accountant ("CPA") with a permit to practice in Kansas.

Q. WHY ARE YOU FILING AMENDED TESTIMONY?

A. I am filing supplemental and corrected testimony (and related revised exhibits) to address changes in the amount of OAG's proposed adjustments related to OAG Adjustment 4 (payroll costs) and OAG Adjustment 5 (long-term incentive costs). The changes in these adjustment amounts cause the OAG's proposed revenue requirement to increase from $1,215,895 (my October 9, 2013 direct testimony) to $2,736,433 per this amended testimony, as shown at Revised Exhibit BCO-2, Schedules A-1 and A-2.

This supplemental and corrected testimony will make it easier (and more timely) for all parties to understand the reasons for the changes in these two adjustments in advance of the scheduled hearing. I have not changed the underlying reasons for my adjustments, just the adjustment amounts.

The changes in these two OAG adjustments will be explained in more detail in amended portions of this testimony addressing Adjustment 4 and 5, although these changes are summarized below:

OAG Adjustment 4 Payroll Costs – The change in this adjustment was caused by two issues: 1) an error in my supporting Excel workpaper calculations; and 2) an error in Atmos' payroll tax amounts reported at FR 16(13)(g) per Schedule G-1 of Mr. Densman direct testimony (also cited at

OAG 1-117) which only shows payroll tax expense and does not include capitalized payroll taxes.

OAG Adjustment 5 Long-Term Incentives – It was not clear to me from Atmos data request responses which amounts of LTIP/Restricted Stock Plan incentives were included in the forecasted test period so I included both amounts from OAG 2-61 and OAG 2-58 to avoid understating this adjustment, and now Atmos has clarified the amount of incentives included in the test period and I have reduced the amount of my adjustment accordingly.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?

A. I am testifying on behalf of the Kentucky Office of the Attorney General ("OAG") in this rate case proceeding regarding Atmos Energy Corporation ("Atmos") request for substantial rate relief.

Q. PLEASE SUMMARIZE YOUR PROFESSIONAL EXPERIENCE AND EDUCATIONAL BACKGOUND.

A. Please see Exhibit BCO-1 for more information regarding my professional experience and educational background. In summary, I am an independent regulatory consultant and a practicing CPA with a specialization in regulatory issues. I have over thirty-three years of regulatory and accounting experience. I have addressed many regulatory issues in numerous state jurisdictions and on an international basis.

I started my consulting practice in 1990, Ostrander Consulting, after leaving the Kansas Corporation Commission ("KCC"). I previously served as the Chief of Telecommunications for the KCC from 1986 to 1990, and was the lead witness on most major issues. I served as Chief Auditor for the KCC from 1983 to 1986, addressing issues regarding telecom, gas, electric, and transportation. In addition, I have worked for international and regional accounting firms, including Deloitte, Haskin and Sells (now Deloitte).

I received a Bachelor of Science degree in Business Administration with a major in Accounting from the University of Kansas in 1978. I am a member of the American Institute of CPAs ("AICPA") and the Kansas Society of CPAs ("KSCPA").

Q. WHAT TYPE OF REGULATORY ISSUES HAVE YOU ADDRESSED?

A. I have addressed many regulatory issues in my career. My experience includes addressing issues related to rate cases under rate of return ("ROR") regulation and TIER requirements, alternative regulation/price cap plans, management audits, specialized accounting and regulatory issues, and other matters.

I have addressed a broad range of issues in my career, including retail and wholesale cost studies, competition, affordable rates/universal service, service quality, infrastructure/modernization, specialized accounting matters, affiliate transactions, income taxes, sale/leaseback, compensation, cross-subsidization, depreciation, rate design, sales/acquisitions and many other matters.

During my tenure at the KCC, I addressed major regulatory issues in the energy and telecom field, including the substantive transition in the telecom industry ranging from the break-up of AT&T and the related introduction of long distance competition, the transition from rate of return regulation to alternative/incentive regulation, the proliferation of alternative carriers, the introduction of the Kansas Relay Service (for speech and hearing impaired persons), and the expansion of services and technology.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE KENTUCKY PUBLIC SERVICE COMMISSION ("COMMISSION") OR ANY OTHER UTILITY REGULATORY COMMISSION?

A. I testified before the Commission in the Big Rivers Electric Corporation ("BREC") rate case in Case No. 2012-00535.[1] In addition, I have testified in numerous other jurisdictions and this information is provided at Exhibit BCO-1.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The primary purpose of my testimony is to address adjustments to Atmos' rate application and sponsor the overall revenue requirement using a traditional rate-of-return ("ROR") on rate base approach. I am not sponsoring testimony related to rate of return, rate design, cost of service, and tariff issues. I will incorporate all adjustment amounts in the revenue requirement calculations at Exhibit BCO-2.

In summary, I will address the following issues:

1) Overall revenue requirement.

2) Individual rate case adjustments.

3) The problems with using Atmos' forecasted test period.

[1] Application of Big Rivers Electric Corporation for a General Adjustment in Rates, Case No. 2012-00535, Direct Public and Confidential Testimony filed May 24, 2013.

Q. CAN YOU SUMMARIZE THE TYPE OF EXHIBITS THAT YOU ARE SPONSORING?

A. Yes, I am sponsoring three types of Exhibits:

1) Exhibit BCO-1 is my curriculum vitae.

2) Exhibit BCO-2, Schedule A-1 summarizes OAG's proposed adjustments and revenue requirements calculation (compared to the revenue requirement of Atmos', along with related supporting schedules showing the detailed adjustments as appropriate.

3) Various other exhibits – These various exhibits include documents that support my testimony.

Q. WILL YOU SUMMARIZE YOUR TESTIMONY?

A. Atmos' application shows a revenue requirement of $13.4 million.[2]

The total impact of OAG recommended adjustments increases operating income and results in a proposed revenue requirement of $2.7 million, and this is a reduction in Atmos' original revenue requirement of $10.7 million.

Q. DID ATMOS USE A FULLY FORECASTED TEST PERIOD?

A. Yes. Atmos used a fully forecasted test period for the twelve month period December 1, 2013 through November 30, 2014. Atmos also uses a

[2] Martin Direct, p. 9, line 13, identifies a revenue increase of $13,367,575.

base period for the twelve month period August 1, 2012 to July 31, 2013, which includes seven months of actual historical data for the period August to February 2013 and five months of estimated data for the period March 2013 to July 2013. Although Atmos' forecasted test period filing appears to be technically compliant with Kentucky statutes, I have concerns with this forecasted filing regarding its lack of documentation, methodology, and specific impacts on costs (and this specific level of detail is not addressed in state statutes).

Q. ARE YOU USING ATMOS' FULLY FORECASTED TEST PERIOD ENDING NOVEMBER 30, 2014 AS THE STARTING POINT FOR ADJUSTMENTS IN THIS CASE?

A. Yes. Although I do not agree with Atmos' use of a fully forecasted test period, the OAG has no other reasonable alternative but to use this same forecasted data as the starting point for adjustments. It would be almost impossible, and certainly impractical, for OAG to attempt to put its own rate case together based on the most recent historical test period. To attempt to put together a completely different rate case filing based on twelve months of historical data would be extremely time consuming, costly, and would create further confusion and problems for the

Commission. In order to be on the same, equal footing of Atmos in preparing an alternative rate case using historical data, the OAG would require virtually the same access as Atmos has to its financial records, operational records, and all other studies and analysis that might affect issues in this case. Clearly these conditions are not going to be met, so the OAG will use Atmos' forecasted test period as the starting point for adjustments.

Q. DO YOU BELIEVE THAT "FAIR, JUST AND REASONABLE RATES" (AS REQUIRED BY STATE STATUTE) CAN BE ACHIEVED VIA ATMOS' FULLY FORECASTED REVENUE REQUIREMENT?

A. No, but my adjustments to Atmos' filing are closer to making the rates fair, just and reasonable.

KENTUCKY OFFICE OF THE ATTORNEY GENERAL RATE OF RETURN

Q. WHAT IS THE PURPOSE OF INCLUDING A RATE OR RETURN ("ROR") IN YOUR REVENUE REQUIREMENT SCHEDULES?

A. First, I want to make it clear that I am not testifying as a ROR witness in this rate case. I am including a ROR in the OAG revenue requirement schedules and calculations as a placeholder for a ROR to be determined by

the Commission at a later date. The OAG is not sponsoring a specific ROR witness, so it is necessary to include a ROR placeholder to complete my revenue requirement schedules. The revenue requirements calculation would not be complete without a ROR placeholder component, and the ROR placeholder that I have included is 7.63%.

Some of the ROR's in recent cases that were considered as placeholders are shown below:

1) 7.63% ROR – Potomac Electric Power Company – Public Service Commission of Maryland.[3]

2) 7.29% ROR - Northern Utilities Inc. d/b/a UNITIL – The Maine Public Utilities Advisory Staff issued a Bench Analysis that proposes a ROR of 7.29%.[4]

[3] In the Matter of the Application of Potomac Electric Company for an Increase in its Retail Rates for the Distribution of Electric Energy, Public Service Commission of Maryland, Case No. 9311, issued July 12, 2013, Appendix I, page 174.

[4] *Northern Utilities Inc. d/b/a UNITIL Proposed Increase in Base Rates (35-A MRSA Section 307),* State of Maine Public Utilities Commission, (Corrected) Bench Analysis, Docket No. 2013-00133, dated September 12, 2013, page 15.

KENTUCKY OFFICE OF THE ATTORNEY GENERAL PROPOSED ADJUSTMENTS

ADJUSTMENT OAG-1-BCO – REMOVE DUPLICATE MAINTENANCE FEES ON LEGACY CUSTOMER INFORMATION SYSTEM ("CIS")

Q. WILL YOU SUMMARIZE ADJUSTMENT OAG-1-BCO (EXHIBIT BCO-2, SCHEDULE A-3)?

A. OAG 2-35 and OAG 1-96 asked Atmos about the propriety and reasonableness of duplicate maintenance fees of $1,400,000 for the legacy (prior) CIS and $2,328,150 for the new customer service system ("CSS") which went live on May 1, 2013. Atmos' response to OAG 2-35(c) admits that it was not appropriate to include duplicate maintenance fees for both customer service centers and that the legacy maintenance fees should be removed from the forecasted test period. Atmos' response to OAG 2-35(b) identifies the Atmos' Kentucky-allocated portion of legacy maintenance fees as $51,262 prior to the application of the 2.7% inflation factor. Because I have removed the impact of Atmos' proposed inflation factor adjustment in the next rate case adjustment that I will propose, it is appropriate to use $51,262 as the adjustment for these legacy maintenance fees.

ADJUSTMENT OAG-2-BCO – REMOVE THE IMPACT OF ATMOS' 2.7% GENERIC INFLATION FACTOR APPLIED TO EXPENSES

Q. WILL YOU SUMMARIZE ADJUSTMENT OAG-2-BCO (EXHIBIT BCO-2, SCHEDULE A-4)?

A. This adjustment removes the impact of Atmos' 2.7% generic inflation factor adjustment from applicable O&M expenses, and reduces related expenses of $496,907. Atmos has failed to meet a reasonable burden of proof regarding this adjustment because: 1) they have failed to show a direct correlation between the actual historical change in these expenses and the 2.7% inflation increase, and; 2) Atmos has not provided additional justification or supporting documentation and calculations for this adjustment.

Q. WILL YOU SUMMARIZE SOME OF THE PRIMARY REASONS SUPPORTING YOUR ADJUSTMENT?

A. Yes. Some of the primary reasons for removing the impact of Atmos' generic inflation factor adjustment include the following:

1) Atmos has not met a reasonable burden of proof regarding this adjustment and has not adequately demonstrated that there is a direct or proper correlation between the 2.7% generic inflation factor and the actual historic changes in the O&M expenses to which Atmos applies this inflation factor.

2) Atmos uses this 2.7% generic inflation factor to improperly forecast increases in various O&M expenses, but many of these same expenses have actually experienced decreases for the most recent fiscal period 2011 to 2012. Thus, Atmos' use of the inflation factor is opposite of what is actually occurring, because it increases expenses that have actually decreased based on historical experience.

3) Atmos does not cite to any supporting documentation or calculations for this adjustment and none could be readily located.

4) Atmos' Schedule D 2.2 (per FR 16(13)(d)2.2) is a list of Atmos proposed adjustments and Adjustment 3 states that the expense reduction of $799,537 represents the forecasted change in expenses (except labor, benefits, rent, and bad debt) from the base period to the forecasted test period and includes a 2.7% inflation factor adjustment. However, Atmos never separately identifies how much of this adjustment is related to a forecasted reduction in expenses and how much is related to a forecasted offsetting increase in expenses related to the 2.7% inflation factor impact.

5) Atmos does not explain if it calculated a 2.7% inflation increase to both the base period and the forecasted test period related expenses.

6) Although Atmos uses the 2.7% generic inflation factor to increase numerous O&M expenses, Atmos admits that it never uses a specific "productivity factor" or "deflation factor" in its forecasting process to reflect decreases in expenses - - Atmos adjustment and forecasting process is biased and one-sided to promote unnecessary and improper increases in expenses.

7) Atmos' generic inflation factor uses data from the Consumer Price Index ("CPI"), but the make-up of the actual CPI "basket of goods and services" is not representative of Atmos' expenses (or Atmos' "basket of goods and services") to which it applies the CPI inflation factor, and this inconsistency is not reconciled or addressed by Atmos.

8) The use of the 2.7% generic inflation factor is an indication of the problems and inaccuracy with Atmos' forecasting process used in this rate case.

Q. HOW DOES ATMOS' EXPLAIN ITS FORECASTING PROCESS THAT USES A 2.7% GENERIC INFLATION FACTOR TO INCREASE ITS EXPENSES?

A. Mr. Densman[5] briefly explains in two sentences that Atmos' forecasting process applies a 2.7% inflation factor to increase all O&M expenses except labor, benefits, rent, and bad debts (insurance is an exception that is increased at 5%), and this is based on average inflation using the CPI for the Midwest region for the three-year period 2010 to 2012.[6] Mr. Densman does not explain if the 2.7% generic inflation factor is applied to both the base period and forecasted test period and he does not cite to supporting documentation or calculations for this adjustment. Atmos' Application does not provide any additional explanation, supporting documentation, or calculations to justify increasing expenses using the 2.7% generic inflation factor.

[5] Densman Direct, p. 15, lines 19 to 23.
[6] The calculation of the 3-year average CPI inflation factor is shown at Atmos' response to OAG 1-111.

Q. CAN YOU EXPLAIN ATMOS' FAILURE TO PROVIDE SUPPORTING DOCUMENTATION AND CALCULATIONS FOR THE 2.7% INFLATION FACTOR ADJUSTMENTS?

A. OAG sought Atmos' supporting calculations and the amount of the expense increase (by account/category) related to the 2.7% inflation factor in at least five data requests, but Atmos did not provide this information. OAG 1-111(b) and (c) asked for a reconciliation from historical expenses to the base period and forecasted test period expenses for each adjustment and change in cost (along with supporting documentation, calculations, and assumptions), and although this would have fully disclosed the amount of the inflation adjustment, Atmos did not provide information or calculations that readily identified the impact of the 2.7% inflation adjustment.

OAG 1-112(a) asked Atmos to explain and show how the 2.7% inflation rate was applied to cost elements in the forecasted test period (this would have shown the amount of increase for each cost element related to the inflation factor), but Atmos did not provide the total amount of the increase (and did not provide the amount of increase for each type of expense) related to the inflation factor.

Atmos' response to OAG 2-51 stated that the 2.7% inflation factor was applied to all cost elements (except labor, benefits, rent, and bad debt) that are listed at Mr. Densman's Direct Testimony Exhibit JCD-1, although this exhibit does not provide or show any calculations related to the 2.7% inflation factor adjustment.

Also, both OAG 1-86 and Staff 1-59 asked for supporting workpapers and calculations (including working Excel versions) for Atmos' adjustments, but it does not appear that Atmos provided any supporting documents for the 2.7% inflation adjustment.

Q. DID ATMOS EXPLAIN IF IT APPLIED THE 2.7% INFLATION FACTOR TO BOTH THE BASE PERIOD AND FORECASTED TEST PERIOD EXPENSES?

A. No, I did not notice that Atmos explained this in testimony or related responses to OAG data requests. Also, Atmos' proposed Adjustment 3[7] does not explain how much of this adjustment is related to other forecasted reduction in expenses and how much is related to the offsetting increase in the inflation factor adjustment.

[7] Schedule D 2.2 (per FR(16)(13)(d)2.2)

Q. HAS ATMOS MET A REASONABLE BURDEN OF PROOF REGARDING THIS ADJUSTMENT AND TO DEMONSTRATE THE CORRELATION BETWEEN THE INFLATION FACTOR AND ATMOS' ACTUAL CHANGE IN EXPENSES?

A. No. Mr. Densman's brief testimony and Atmos' responses to OAG data requests do not meet a reasonable burden of proof and do not provide adequate explanation or supporting documentation to demonstrate that there is a direct or reasonable correlation between the 2.7% inflation factor and the actual historical change in expenses to which the inflation factor is applied. In fact, Atmos' response to OAG data requests demonstrates just the opposite.

OAG 1-112(b) asked Atmos to explain and provide supporting documentation to show the correlation between actual historical changes in expenses and the 2.7% inflation increase that Atmos used for these same expenses. Atmos' response to OAG 1-112(b) states, "...there is no direct correlation as inflation is only one of these factors." It appears that even Atmos agrees there is no direct correlation between actual changes in expenses and the 2.7% inflation factor used for increasing these expenses. Atmos admits that inflation is "just one factor" to be considered in the

change of expenses, but Atmos did not specifically identify the other factors.

Also, Atmos' response to OAG 1-112 referred to Attachment 1 of the response which showed historical changes in expenses subject to Atmos' 2.7% inflation factor adjustment. However, the information shown at Attachment 1 actually supports a conclusion contrary to Atmos' position, and this information is displayed in Table BCO-1 below. Atmos applied a 2.7% increase to all eleven categories of expenses identified at OAG 1-112 Attachment 1, although at least seven categories of these expenses experienced actual decreases in amounts for the most recent historical periods available and all combined expenses showed an overall decrease in amount (comparing the change from 2011 to 2012 as shown in Table BCO-1 below). Table BCO-1 shows a total decrease of $470,563 for all of these expenses that were subject to Atmos' 2.7% inflation factor increase. Atmos did not explain or provide supporting documentation to demonstrate why expenses that have an actual recent history of decreases in amounts should be increased by a generic 2.7% inflation factor in this rate case. Atmos' position in this regard is unreasonable, unjustified and does not meet a reasonable burden of proof.

Table BCO-1 - Actual Historical Decrease in Expenses is Contrary to Atmos' 2.7% Inflation Factor Increase for These Same Expenses

	Type of Expense	Fiscal 2011		Fiscal 2012	Change
1	Vehicles & Equip	967,528	-16%	817,068	(150,460)
2	Materials & Supplies	593,269	-1%	586,880	(6,390)
3	Information Technologies	11,932	47%	17,550	5,617
4	Telecom	214,653	5%	224,999	10,345
5	Marketing	156,529	-12%	137,577	(18,952)
6	Directors & Shareholders & PR			128	128
7	Dues & Donations	80,016	-56%	35,264	(44,752)
8	Print & Postages	11,024	14%	12,583	1,559
9	Travel & Entertainment	344,255	-36%	219,260	(124,995)
10	Training	21,482	-41%	12,732	(8,750)
11	Miscellaneous	407,065	-33%	273,152	(133,913)
	Expenses Subject to Inflation Factor	$ 2,807,755		$ 2,337,191	$ (470,563)

Q. ALTHOUGH ATMOS APPLIED A 2.7% INFLATION INCREASE TO EXPENSES THAT HAVE PREVIOUSLY DECREASED BY $470,563, DID YOU PROPOSE ANY ADJUSTMENTS TO REDUCE THESE EXPENSES?

A. No, I only removed the impact of Atmos' 2.7% inflation factor adjustment in this specific adjustment. The limited information that Atmos did provide for these expenses shows an actual decrease of $470,563 for the most recent comparative periods available, so I will take this into consideration as I evaluate other adjustments in this rate case.

Q. WHY DID YOU REMOVE "OUTSIDE SERVICES" EXPENSES FROM YOUR PRIOR ANALYSIS INCLUDED AT TABLE BCO-1?

A. Atmos' response to OAG 1-112 indicated that a 2.7% inflation factor was applied to Outside Services, although these expenses increased by $1.6 million or 117% from 2011 to 2012 as shown below:

Type of Expense	Fiscal 2011		Fiscal 2012	Change
Outside Services	1,409,379	117%	3,056,543	1,647,164

This might lead one to incorrectly conclude that applying a 2.7% inflation factor to these costs is reasonable, given the historical increase of $1.6 million and 117% from 2011 to 2012. However, it is clearly inappropriate to apply a generic 2.7% inflation factor to Outside Services regardless of whether these expenses increased or decreased from the prior year amounts.

Outside Services usually reflect payments made to various types of outside professionals and consultants for various recurring and non-recurring services which can fluctuate significantly from one year to the next. Thus, a 117% increase in these expenses from 2011 to 2012 may be the result of significant one-time services related to specialized studies or services that were provided in 2012 and which were not previously

provided in 2011. It would not be proper to apply a 2.7% inflation factor to the entire group of Outside Service expenses for 2012 when some of these services and related contracts may not be provided in 2013, 2014, or future years.

Also, it is not appropriate to apply a 2.7% generic inflation factor to the entire group of Outside Services because many of these services are (and should be) subject to underlying written and formal contracts, engagement letters, purchase orders, and responses to Requests for Proposals which guide these costs on a case-by-case basis. Various Outside Services should be based on a contract reflecting a very specific scope of services, including a specific number of hours tied to identified tasks to be performed, and specific hourly billing rates that vary by the specific contractor/consultant providing these services. To take a collective group of contract costs for Outside Services and just increase these costs by a 2.7% inflation factor would be highly inefficient, imprudent, and reflect extremely poor budgeting. This greatly oversimplified approach would assume that every single contractor and outside professional of Atmos will increase their billing rates and their hours by the exact same amount of 2.7%, and that these same contracts

will remain in place for each year without any changes in scope or type of services being provided.

Atmos indicates that its forecasted test year costs are based to a large degree upon its internal forecasting process, and if the 2.7% generic inflation factor is in fact one of Atmos' primary internal budget assumptions this causes me great concern. This type of guiding budget assumption would be a general indication that Atmos' budgeting process is flawed, not cost-based, and is biased towards cost increases in this rate case. If the 2.7% generic inflation factor is a routine budget assumption that is applied to Outside Services and other expenses for which there is no direct correlation from historical changes in expenses, then this reflects poorly on the credibility of Atmos' budgeting process.

Q. DID ATMOS USE "PRODUCTIVITY FACTORS" TO DECREASE SOME OF ITS EXPENSES AND TO FAIRLY BALANCE ITS USE OF AN "INFLATION FACTOR" TO INCREASE ITS EXPENSES?

A. No. Atmos' response to OAG 1-112(e) states that no productivity factors were used, but to the extent productivity gains are expected and achievable, they are reflected in the annual budget. However, Atmos does

not specifically identify any productivity gains or efficiencies that are reflected in the annual budget or this rate case, and this is consistent with Atmos' responses to other data requests that do not specifically identify any cost savings or efficiencies reflected in this rate case. It seems very inappropriate and one-sided that Atmos imposes a 2.7% generic inflation increase on a significant amount of its total O&M expenses in this rate case (24% of its total O&M expenses), but fails to apply a specific productivity factor to even one single expense category, which would at least give the appearance of some sense of fairness or balance. Again, the credibility of Atmos' budgeting process must seriously be questioned when the Company approach appears geared towards increasing expenses in this rate case without any specific application of cost savings or efficiencies.

Q. HOW DID YOU CALCULATE AN ADJUSTMENT TO REMOVE THE IMPACT OF ATMOS' GENERIC 2.7% INFLATION FACTOR?

A. I did the best I could with the limited information and explanation provided by Atmos. Atmos' response to OAG 2-51 explains that it applied a 2.7% inflation factor to the O&M expenses included at Mr. Densman's Exhibit JCD-1, although this exhibit does not provide the amount of Atmos' inflation adjustment. The supporting calculations for

adjustment are shown at Exhibit BCO-1, Schedule 2. To explain briefly, I took the forecasted test period O&M expenses (claimed by Atmos to be subject to the 2.7% inflation factor) and multiplied this amount by the 2.7% inflation factor to determine an expense increase of $248,454 for the forecasted test period. Next, I doubled this inflation factor impact to an amount of $496,907 to reflect an estimated inflation factor impact for the base period increase that Atmos may have carried forward to inclusion in the forecasted test period amounts. This total amount of $496,907 was removed as the estimated impact of Atmos' 2.7% inflation adjustment. If Atmos did not reflect the 2.7% inflation adjustment in both the base period and forecasted test period, then I am not opposed to removing the base period inflation impact from my adjustment.

ADJUSTMENT OAG-3-BCO – ADJUST SHARED SERVICES UNIT ("SSU") AND DIVISION GENERAL OFFICE ("DGO") EXPENSES ALLOCATED TO ATMOS

Q. WILL YOU SUMMARIZE ADJUSTMENT OAG-3-BCO (EXHIBIT BCO-2, SCHEDULE A-4)?

A. Atmos has failed to meet a reasonable burden of proof regarding its proposed significant and unexplained forecasted increases in SSU, DGO, and Kentucky Direct expenses. Atmos failed to provide the most

important information requested by OAG, which is an explanation of significant changes in the amount of SSU, DGO, and Kentucky Direct expenses by account and description from 2010 through the forecasted test period. SSU and DGO expenses showed a consistent declining trend of 2% to 4% for the three-year period 2009 to 2011, although the 2012 actual expenses increased by 7%. For the base period and forecasted test period, Atmos increased these forecasted expenses by 30% over these two years (a total amount of $3.0 million) without providing adequate explanation and documentation for this significant increase. In addition, a review of the underlying SSU, DGO and Kentucky Direct expenses for the actual periods 2010, 2011, 2012, and the base period revealed significant and unusual increases in expenses which Atmos did not address. At this time, I am proposing to remove $1,492,500 (or one-half) of of the base period and forecasted test period increases of $2,985,000, which allows an increase in expenses of about 7.5% for the base period and 7.5% for the forecasted test period. This 7.5% increase in SSU and DGO expenses is very reasonable and exceeds the 3-year average actual increase of 4% in these expenses from 2010 to 2012. I believe a similar adjustment could also be appropriate for Kentucky Direct expenses.

Q. REGARDING THE SSU AND DGO ALLOCATED EXPENSES, DO YOU HAVE CONCERNS REGARDING THE LACK OF SUPPORTING DOCUMENTATION AND REQUESTED INFORMATION WHICH ATMOS FAILED TO PROVIDE TO THE OAG?

A. Yes, I have significant concerns. Atmos failed to provide explanations, supporting documentation and calculations to support the SSU and DGO allocated costs in both its testimony and in OAG data requests. Atmos has failed to meet a reasonable burden of proof for these SSU/DGO allocated expenses because it has failed to provide adequate and meaningful supporting documentation, and therefore, my proposed adjustment should be adopted.

Q. CAN YOU PROVIDE A LIST OF SOME OF THE MOST IMPORTANT SUPPORTING DOCUMENTATION THAT ATMOS FAILED TO PROVIDE, ALONG WITH OTHER CONCERNS THAT YOU HAVE IDENTIFIED?

A. Yes, a list of such information and related concerns is summarized below:

1) **No Explanation for Significant Changes in SSU, DGO and Kentucky Allocated Expenses For 2010 Through Forecasted Test Period (OAG 1-154(b))** – Atmos failed to provide the requested explanation and supporting documentation for significant changes in these expenses for each of the years 2010, 2011, 2012, base period, and forecasted test period. Atmos' response to OAG 1-154 did not provide SSU, DGO, and Kentucky allocated amounts for the

forecasted test period and this is a concern because the amounts for the forecasted test period are the most important information in the rate case. It is not clear if most of the SSU, DGO and Kentucky allocated amounts for the base period were also the same for the forecasted test period (to explain why forecasted amounts were not provided), but if that is the case then there is no reconciliation or detailed calculations for forecasted amounts that increased by 20% (or $2.2 million) over the base period expenses.

2) **No Proof That SSU, DGO, and Kentucky Allocated Expenses are Reasonable, Prudent, and Fair (OAG 1-154(f))** - Atmos did not provide any explanation or documentation to show that these expenses are reasonable, prudent and fair. Instead Atmos just referred to its Cost Allocation Manual ("CAM") in response to this data request. However, the Cost Allocation Manual does not establish reasonableness, prudency, and fairness for the underlying specific expenses. Indeed, the CAM only establishes an allocation method and factor for allocation such expenses.

3) **No Proof That SSU, DGO, and Kentucky Allocated Expenses are Reflected at the Lower of Cost or Fair Market Value, or Other Reasonable Amounts (OAG 1-154(c),(d), and (e))** - Atmos did not provide any explanation or documentation to show that these expenses are charged to Atmos at the lower of cost or fair market value, or that these expenses are representative of costs for similar services and products provided by other third-party vendors in the market. Atmos states that it has not performed a study for this requested information. Holding companies and nonregulated affiliates have an incentive to allocate excessive or uneconomic costs to their regulated affiliates in order to recover amounts through the regulatory process which cannot easily be easily recovered elsewhere, and recovery through the regulatory process can allow the holding company/unregulated affiliate to subsidize its more competitive operations.

4) **No Analysis of Reasonableness Test of Allocated Expenses** - Atmos has not provided any analysis or tests to show that the total Administrative and General Expenses (or overhead expenses) of Atmos (including SSU, DGO, and Kentucky Direct) are reasonable or consistent with the industry. If allocated amounts are

unreasonable or excessive this can act as a form of an indirect dividend paid that is reimbursed to the regulated utility to the holding company or other entities.

5) **No Supporting Documentation and Calculations for Shift of Expenses to Kentucky Due to the Sale of Georgia Operations (OAG 1-155(a) and 2-73))** - Atmos proposes an adjustment to shift increased expenses of about $2.6 million to the Kentucky Atmos due to the sale of its Georgia operations, and thus no DGO expenses are being allocated to Georgia. Although OAG 1-155 and 2-73 provide the amount of expenses shifted to Kentucky Atmos due to the Georgia sale, Atmos does not provide the requested supporting documentation and calculations for these amounts. In fact, OAG 2-73 only shows the change in the allocation factor, but does not explain or identify the amount of expenses by account number or description. It is not possible to determine how Atmos calculated this $2.6 million adjustment, the specific types of expenses shifted to Kentucky Atmos, and whether this is reasonable.

6) **Atmos' Workpapers Show Inconsistent Base Period Amounts for SSU, DGO, and Kentucky Allocated Expenses (OAG 1-154 , Exhibit JCD-1, and Schedule I.1))** – For the base period ending July 31, 2013, Atmos' response to OAG 1-154 Attachment 1 does not show the same amount of Kentucky direct expenses, DGO expenses, and SSU expenses that are included in both Exhibit JCD-1 and Schedule I-1, and this difference of $324,252 is not explained or reconciled.[8] It is not clear which source includes the correct amount. However, Atmos' response to OAG 1-154 is the only document that has been provided with amounts for each account number for periods 2010, 2011, 2012, and the base period (the forecasted test period was not provided). Thus, if the amounts in in OAG 1-154 are incorrect, this means that Atmos did not provide accurate SSU, DGO, and Kentucky allocated expenses by account number and description for any data request, and that is because this level of documentation was never provided for amounts in Exhibit JCD-1 and Schedule I-1 as shown in the table below:

[8] Although the difference of $324,252 may not appear significant between these various documents, the underlying differences and fluctuations between each specific type of expense may be significant.

Table BCO-2: Inconsistent SSU and DGO Expenses from Various Sources

	Base Period Amounts		
	OAG 1-154	Exh. JCD-1	Sch. I-1
Kentucky Direct	$14,593,405	$13,892,232	$13,892,000
Division General Office	$4,042,707	$4,466,231	in below amount
Shared Services Unit	$6,457,216	$6,410,613	$10,877,000
	$25,093,328	**$24,769,076**	**$24,769,000**
Difference between OAG 1-154 and other schedules			$324,252

Q. WILL YOU SHOW THE TRENDS AND CHANGES IN SSU, DGO, AND KENTUCKY DIRECT EXPENSES FROM 2009 THROUGH THE FORECASTED TEST PERIOD?

A. Yes. This information is shown in Table BCO-3 below, and I will address these changes as part of the support for my proposed adjustment.

Table BCO-3: Change in Direct/Allocated Expenses 2009 through Forecasted Test Period

							Atmos
							Adjustments -
						Forecast	Actual 2012
	Most Recent Five Calendar Years				Base Year	Test Year	to Forecasted
	2009	2010	2011	2012	7/31/2013	11/30/2014	Test Year
Direct O&M - KY	**$14,181**	**$11,226**	**$13,366**	**$12,980**	**$13,892**	**$13,626**	
Change Prior Yr.	$1,447	($2,955)	$2,140	($386)	$912	($266)	$646
% Change	11%	-21%	19%	-3%	7%	-2%	5%
SSU + DGO	**$10,071**	**$9,668**	**$9,412**	**$10,086**	**$10,877**	**$13,071**	
Change Prior Yr.	($182)	($403)	($256)	$674	$791	$2,194	$2,985
% Change	-2%	-4%	-3%	7%	8%	20%	30%
Total Expenses	**24,252**	**20,894**	**22,778**	**23,066**	**24,769**	**26,697**	
Change Prior Yr.	$1,265	($3,358)	$1,884	$288	$1,703	$1,928	$3,631
% Change	6%	-14%	9%	1%	7%	8%	14%

Q. CAN YOU EXPLAIN ATMOS' ADJUSTMENT TO SSU AND DGO EXPENSES IN THE CONTEXT OF HISTORICAL CHANGES?

A. Yes, I will be citing to information from Table BCO-3 above and I will primarily focus on the amounts and percentages related to the row titled "SSU+DGO." From 2008 through 2011 there was a consistent trend of reductions for SSU and DGO ranging from 2% to 4%.

In 2012, SSU and DGO expenses increased by a significant and unexplained amount of $674,000 (7% increase), and Atmos failed to provide a response to OAG's data request seeking an explanation for this increase. The 2012 expenses are the most recent actual twelve month period of expenses available (although actual expenses are available from January through July 2013).

In the base period ending July 31, 2013, Atmos forecasted another significant increase of $791,000 (8% increase) for the SSU and DGO expenses, although this consists of seven months of actual data and five months of projected data. This represents two years in a row with significant and unusual increases (7% increase in 2012 and 8% increase in the base period), after three prior successive years decreases in actual SSU and DGO expenses. Moreover, Atmos has failed to provide detailed explanations and supporting documentation (although some or all of this

amount may be related to the shift of expenses to Kentucky from Georgia operations as I will address for the forecasted test period increase).

Finally, in the forecasted test period ending November 31, 2014, Atmos projected an increase of $2.2 million and 20%. This increase of $2.2 million is identified at Schedule D.2.2 as Atmos Adjustment 5, but Atmos provides no explanation for this significant increase and only vaguely states that this represents a forecasted amount of expenses allocated from SSU and DGO. Atmos' response to OAG 1-153 appears to indicate that most of this increase of $2.2 million is related to a $2.6 million shift of SSU and DGO expenses to Kentucky due to the sale of Georgia operations on April 1, 2013. According to the company's response to OAG 2-73, Atmos will no longer allocate SSU and DGO expenses to Georgia and these expenses must be absorbed by the remaining other states in the Kentucky/Mid-States Division. However, Atmos never provided any detailed supporting documentation or calculations for the $2.2 million or $2.6 million expense amounts as requested in OAG 1-153 and 2-73. Also, Atmos' response to OAG 1-154 did not provide a column showing SSU and DGO expenses by type and description for the forecasted test period, and so the Atmos' proposed $2.2 million increase for the forecasted test period cannot be reconciled to OAG 1-154. Thus, the reasonableness of

the calculation and the type of expenses being shifted could not be evaluated for reasonableness or propriety.

Q. DOES ATMOS' TOTAL PROJECTED INCREASE IN SSU AND DGO EXPENSES LOOK UNUSUAL FOR THE PERIOD BEGINNNING WITH ACTUAL AMOUNTS IN 2012 THROUGH THE FORECASTED TEST PERIOD AMOUNTS AT NOVEMBER 2014?

A. Yes. As indicated in Table BCO-3, the total projected increase in SSU and DGO expenses from the last known actual data in 2012 through the forecasted test period ending November 31, 2014 is about $3.0 million ($2,986,000), which is a 30% increase (15% per year for the 2013-2014 period). This projected increase is very significant and unusual, and is more than double the 2012 actual increase of 7%. In addition, when counting the 7% actual increase in these expenses for 2012, this represents total SSU and DGO increases of $3.7 million and 37% for the period January 1, 2012 through November 31, 2014, for which Atmos has not provided adequate supporting explanation and documentation.

Q. WOULD YOU BE SATISFIED IF ATMOS PROVIDED DOCUMENTATION SHOWING THAT THE $2.2 MILLION FORECASTED TEST PERIOD INCREASE WAS RELATED TO THE SHIFT IN EXPENSES FROM GEORGIA TO KENTUCKY?

A. No. I am not opposed to an adjustment to reflect the shift of expenses from Georgia to Kentucky if proper documentation and calculations can be provided and the amount is reasonably known and measurable (and I have allowed some portion of this increase in my adjustment). However, that does not satisfy all of my concerns regarding the remaining specific underlying forecasted test period expenses of $11.5 million[9] and it does not satisfy me regarding the reasonableness of the specific underlying forecasted expenses comprising the $2.2 million shift to Kentucky. I still have significant concerns that some of these specific underlying expenses are forecasted inaccurately and that some of these expenses should not be recovered in their entirety from ratepayers due to other regulatory policy and concerns. I believe that the adjustment of these other SSU and DGO expenses could offset and even exceed the $2.2 million related to the shift of expenses from Georgia to Kentucky operations.

[9] Forecasted test period SSU and DGO expenses of $13.1 million less claimed $2.2 million of expenses shifted from Georgia to Kentucky.

Q. CAN YOU PROVIDE SOME EXAMPLES OF OTHER UNUSUAL AND SIGNIFICANT INCREASES IN SSU AND DGO EXPENSES FROM 2010 THROUGH THE BASE PERIOD THAT ATMOS HAS FAILED TO ADDRESS IN DATA REQUEST RESPONSES TO OAG?

A. Yes. Confidential Exhibit BCO-2, Schedule 7 includes information from OAG 1-154 Confidential Attachment 1, and is a list of certain specific significant increases and/or unusual amounts for SSU and DGO expenses for the periods 2010, 2011, 2012, and the base period. Atmos did not provide the requested explanation of amounts and reasons for unusual or significant changes from year-to-year for these expenses. The unexplained significant changes for each year further justify my proposed adjustment to SSU and DGO expenses.

REVISED ADJUSTMENT OAG-4-BCO – REMOVE UNEXPLAINED SIGNIFICANT INCREASES IN PAYROLL AND BENEFIT COSTS

Q. WILL YOU EXPLAIN WHY YOU ARE REVISING ADJUSTMENT OAG-4?

A. Yes. The change in this adjustment was caused by two issues:

1) An error in my supporting Excel workpaper calculations (during the process of preparing my spreadsheet I inserted certain columns and lines which caused mis-alignment and the wrong amounts to appear in other cells).

2) An error in Atmos' payroll tax amounts reported at FR 16(13)(g) per Schedule G-1 of Mr. Densman's direct testimony (also cited at OAG 1-117) which reports expensed and capitalized amounts for Atmos payroll labor costs and benefits, but incorrectly shows only the expensed amount of payroll taxes (and does not also properly include the capitalized amount of payroll taxes). It appears the correct amount of payroll taxes expensed and capitalized are provided at Atmos' response to OAG 1-120 and I have relied on these amounts for this adjustment. My original payroll adjustment did not include the impact of payroll taxes because it was not clear which amounts were correct, and my revised payroll adjustment now includes the impact of payroll taxes and relies on Atmos response to OAG 1-120 for these amounts.

It is important to emphasize that the underlying reasons supporting my payroll adjustment have not changed because: a) I am consistently removing 50% of Atmos' proposed payroll increase; and b) Atmos' proposed and forecasted payroll expense increase is excessive.

Q. WILL YOU SUMMARIZE THIS PAYROLL AND BENEFITS ADJUSTMENT OAG-4-BCO (EXHIBIT BCO-2, SCHEDULE A-7) AND EXPLAIN WHY MR. DENSMAN'S TESTIMONY ON THIS MATTER MAY BE MISLEADING?

A. Mr. Densman briefly addresses Atmos' payroll and benefits issues in about one page of testimony,[10] but he does not disclose the significant amount and unusual nature of Atmos' proposed payroll increase. In fact, Mr. Densman's testimony only discloses that Atmos included a 3% base

[10] Densman Direct, page 14, lines 9 to 23, and page 15, lines 1 to 9.

pay increases for October 2012 and October 2013 in its payroll adjustment. This might lead one to believe that the payroll increase for the base period and forecasted test period was perhaps only 3% per period, or 6% total for the combined base and forecasted test periods. Also, Mr. Densman does not specifically explain that Atmos has also proposed significant increases for SSU and DGO payroll labor, benefits, and payroll tax costs that are allocated to Kentucky operations. In truth, Atmos proposes to increase payroll labor, benefits, and payroll tax expense by 17.31% (or $2.4 million) for the combined base and forecasted test periods (and combined expensed and capitalized payroll is proposed to increase 20.06%)[11], and this is significantly greater than actual prior year increases for which information has been made available by Atmos. Although Atmos proposes to increase total payroll labor, benefits, and payroll tax expense by 17.31%, some of the percentage increases for the individual payroll cost components are significantly larger, including a 46.51% increase in Atmos' Kentucky Direct payroll benefit expense (although the payroll benefits expense increase for SSU & DGO is 17.55%).[12] I am proposing to reduce Atmos' payroll adjustment by $1.2 million, and this will allow a total

[11] This increase is calculated as the difference between the actual payroll and benefits expense at December 31, 2012 compared to Atmos' forecasted payroll and benefits expense for the forecasted test period at November 30, 2014.
[12] Please see Revised Exhibit BCO-2, Revised Schedule A-7 for detailed components and calculations.

payroll labor/benefit/payroll tax increase of $1.2 million (or 8.66%, which is about one-half of Atmos' proposed 17.31% increase) for the base and forecasted test periods.

Q. WILL YOU COMPARE YOUR PAYROLL/BENEFITS EXPENSE ADJUSTMENT TO THE ADJUSTMENT PROPOSED BY ATMOS?

A. Yes. Please see the table that follows, and the first column is most important because it compares my proposed payroll labor, benefits, and payroll tax expense to that proposed by Atmos (for both "Kentucky Direct" and for "SSU & DGO" allocated amounts), and the difference between these two expense amounts is my proposed adjustment. For example, Atmos proposed an increase[13] of $2,425,424 and I proposed an increase of $1,212,712, and the difference of $1,212,712 is my proposed adjustment (because I am proposing to remove one-half (50%) of Atmos' proposed payroll increase, this means that both the amount that I allow and the amount that I disallow are the same amount).

[13] The increase is for the base period and forecasted test period (from fiscal year end 2012 through the forecasted test period ending November 30, 2014.

Table BCO-4: Summary of OAG Payroll/Benefits adjustment by category (Revised Exhibit BCO-2, Revised Schedule A-7, page 2 of 2)

A	B	C	D
Line		Forecasted Test Period	
			Total Expense
	Table BCO-4:	Expense	& Capital
	Kentucky Direct - OAG Adjustment		
1	OAG Actual 2012 Payroll labor, benefits, and taxes	$7,224,401	$15,791,251
2	Atmos Forecasted Payroll labor, benefits, and taxes	$8,865,683	$19,059,057
3	Total Atmos Increase Subject to Adj.	$1,641,282	$3,267,806
4	Atmos Proposed Percent Increase	22.72%	20.69%
5			
6	**SSU & DGO - OAG Adjustment**		
7	OAG Actual 2012 Payroll labor, benefits, and taxes	$6,786,661	$10,752,617
8	Atmos Forecasted Payroll labor, benefits, and taxes	$7,570,803	$12,428,794
9	Total Atmos Increase Subject to Adj.	$784,142	$1,676,177
10	Atmos Proposed Percent Increase	11.55%	15.59%
11			
12	Total Kentucky & SSU/DGO Subject to Adj.	$2,425,424	$4,943,983
13	OAG Adjustment at one-half of increase	0.5	18.63%
14	**OAG Proposed Reduction in Payroll Exp.**	**$1,212,712**	

Q. WILL YOU ALSO COMPARE THE AMOUNT OF PROPOSED PAYROLL AND BENEFITS EXPENSE INCREASES PROPOSED BY ATMOS AND OAG?

A. Yes, this information is shown in the table below. This table shows the amount and percentage payroll labor, benefits, and payroll tax expense increases proposed by Atmos and OAG for each category, for the combined base and forecasted test periods subsequent to the actual 2012 period. This table shows that Atmos proposes a total payroll/benefits/tax increase of $2.4 million and 17.31% (or about a 8.66%% increase for each of

the base period and forecasted test period), and OAG proposes a total payroll/benefits/tax increase of $1.2 million and 8.66% (or about an 4.33% increase for each of the base period and forecasted test period). The OAG adjustment and OAG allowed increases in payroll/benefits/taxes of $1.2 million and 4.33% for each of the base period and forecasted test period is very fair and reasonable, and it even exceeds averaged payroll/benefit/taxes increase amounts and percentages for all actual prior years 2008 through 2012 that were made available by Atmos. Arguably, I could have reasonably proposed a steeper adjustment.

Table BCO-5: Comparison of OAG and Atmos allowed payroll/benefit increases (Revised Exhibit BCO-2, Revised Schedule A-7, page 2 of 2)

Increase in "Expense"	Atmos Proposed Increase		OAG Proposed Increase	
Type of Payroll	Atmos $	Atmos %	OAG $	OAG %
Kentucky Direct - Payroll	$611,103	12.92%	$305,552	6.46%
Kentucky Direct - Benefits	$1,003,687	46.51%	$501,844	23.26%
Kentucky Direct - Payroll Taxes	$26,492	7.83%	$13,246	3.92%
SSU & DGO - Payroll	$519,373	12.09%	$259,687	6.04%
SSU & DGO - Benefits	$206,419	9.57%	$103,210	4.78%
SSU & DGO - Payroll Taxes	$58,350	17.55%	$29,175	8.78%
Total Expense Increase Proposed	**$2,425,424**	**17.31%**	**$1,212,714**	**8.66%**
Note: OAG proposes an increase of $1,212,712, and a decrease of $1,212,712 (one-half) to Atmos' proposed total payroll expense increase.				

Q. CAN YOU EXPLAIN WHY ATMOS' PROPOSED ADJUSTMENT TO PAYROLL AND BENEFITS IS NOT REASONABLE?

A. Yes. I will summarize some of my primary concerns with Atmos' payroll/benefits adjustment, and these are some of the same reasons that support the OAG adjustment below:

1) Atmos' payroll adjustment and related calculations are not transparent and it required numerous data requests to gain underlying information, although Atmos has still not provided a detailed explanation, calculations, or workpapers with assumptions that support its proposed significant payroll increase. In contrast, I have a detailed workpaper with calculations and assumptions regarding the OAG payroll adjustment.

2) Mr. Densman's testimony can give the impression that Atmos' proposed payroll increase was limited to 3% base pay increases for October 2012 and October 2013, but in reality Atmos is seeking significant and unsubstantiated payroll expense increases of 17.31% for the combined base and forecasted test periods, an average increase of 8.66% for each period. In fact, Atmos' Kentucky Direct proposed payroll expense increase of 22.72%[14] for the combined base and forecasted test period is exceedingly unusual and significant. In comparison, OAG is proposing a Kentucky Direct payroll expense increase of 11.36% (one-half of Atmos' propose Kentucky Direct payroll increase) for the combined base and forecasted test periods, an average increase of 5.68% for each period. OAG's payroll adjustment is very reasonable and fair by most comparisons.

3) For combined expensed and capitalized payroll labor, benefits, and taxes[15] for **Kentucky Direct**, Atmos proposes a 20.69%[16] forecasted increase for the combined base and forecasted test year (10.35% per

[14] See Table BCO-4 and Revised Exhibit BCO-2, Revised Schedule A-7, page 2 of 2.
[15] The percentage increase for combined "total expensed and capitalized" payroll will be different than the percentage increase for just the "expensed" portion of payroll.
[16] See Table BCO-4 and Revised Exhibit BCO-2, Revised Schedule A-7, page 2 of 2.

year for the base and forecasted test periods) although the "actual" increases for the prior years is only -2.92% from 2011 to 2012, 2.65% from 2010 to 2011, 1.69% from 2009 to 2010, and 5.59% from 2008 to 2009.[17] Thus, Atmos' total forecasted increase for expensed and capitalized payroll is substantially greater than actual experience for prior years made available by Atmos, and it is also much larger than the claimed 3% annual base pay increase mentioned in Mr. Densman's testimony.

4) Regarding the prior bullet point related to payroll labor, benefits, and taxes for **Kentucky Direct** the 20.69% increase translates to a total increase in expensed and capitalized payroll of $3,267,806 from FYE 2012 through the end of the forecasted test period (an average increase of $1,633,903 for each of the base period and forecasted test period). In comparison, the actual historical payroll changes were an increase of $825,138 in 2009, $263,622 in 2010, $419,225 in 2011, and a decrease of $474,677 in 2012, and have never been larger than $825,138 (from 2008 to 2009) for the periods 2009 through 2012 made available by Atmos. Thus, Atmos average proposed forecasted payroll increase of about $1,633,903 for each of the base period and forecasted test period is already more than six times greater than the actual payroll increase of $263,622 in 2010; more than four times greater than the actual payroll increase of $419,225 in 2011, and significantly greater than the actual payroll decrease of $474,677 in 2012.

5) Atmos proposes all of the above significant increases in payroll and benefits, although its response to OAG 1-117 shows that the number of employees (209 employees) does not change from 2012 through the forecasted test period, so the proposed significant increases cannot be related to forecasted increases in employees.

6) For combined expensed and capitalized payroll, for **SSU and DGO,** Atmos proposes a 14% decrease ($1.5 million decrease) from actual 2012 through the partially forecasted base period, but this is somewhat deceiving because then Atmos proposes a 34% increase ($3.1 million increase) from the base period to the forecasted test period, which results in a total increase of $1.7 million (16%

[17] See Revised Exhibit BCO-2, Revised Schedule A-7, Page 2 of 2 (amounts are from Atmos' response to OAG 1-117, FR 16(13)(g), Schedule G-2, Witness: Mr. Densman.

increase) for the combined base and forecasted test periods.[18] Atmos does not explain and provide adequate supporting documentation for these unusual shifts and changes in amounts.

7) I do not specifically oppose Atmos' 3% base pay increase in October 2012,[19] and my adjustment allows for this increase and amounts above that. However, I am fundamentally opposed to Atmos' proposed base pay increase of 3% for October 2013, because this is not known and measurable, the number of related employees and turnover for October 2013 are not known or measurable, and offsetting possible efficiencies are not known and measurable at this time. Most importantly, I am opposed to the concept of allowing this 3% "merit" increase, because the merits of employees cannot be pre-determined or evaluated significantly in advance of October 2013 - - performance evaluations have not yet been performed for the twelve months ending October 2013 and it is not possible to determine each individual employee's performance. Atmos has not provided documentation that shows it has a specific amount of dollars set aside for merit pay in 2013, and even if it does, a true merit pay system is not defined by a bucket of dollars but should fluctuate each year based on actual employee's performance.

Q. SHOULD THE COMMISSION REJECT ATMOS' PAYROLL ADJUSTMENT DUE TO ITS FAILURE TO MEET A REASONABLE BURDEN OF PROOF?

A. Yes, Atmos has failed to adequately explain, document, and support its proposed significant payroll increase for the base and forecasted test periods.

[18] See Revised Exhibit BCO-2, Revised Schedule A-7, Page 2 of 2.
[19] I do not oppose the 3% base pay increase for October 2012, as long as this is limited strictly to the base pay increase and does not include other miscellaneous increases.

REVISED ADJUSTMENT OAG-5-BCO – REMOVE ONE-HALF OF INCENTIVE COMPENSATION COSTS FOR OFFICERS AND MANAGEMENT

Q. WILL YOU EXPLAIN WHY YOU ARE REVISING ADJUSTMENT OAG-5?

A. Yes. It was not clear to me from Atmos' response to OAG 2-61 Attachment 3 and OAG 2-58 Attachment 6[20] which amounts of LTIP/Restricted Stock Plan incentives were included in the forecasted test period, so in my original testimony I included both amounts from OAG 2-61 and OAG 2-58 to avoid understating this adjustment. Atmos has now clarified the amount of incentives included in the test period and I have reduced my adjustment accordingly, which I have also explained in my response to Atmos Question 38 and 42 (Atmos data requests to the OAG). The revised adjustment is a reduction of $582,228 in long-term incentive expense as shown at Revised Exhibit BCO-2, Revised Schedule A-8. In addition, I inadvertently failed to make the corresponding reduction to capitalized long-term incentives, and this adjustment is now reflected as a reduction of $391,201 to rate base. It is important to emphasize that the

[20] It was not clear if the 2012 amounts included in the response to OAG 2-61 Attachment 3 were also assumed to be the same amount for the forecasted test period and/or if these amounts were the same or different incentive amounts included in response to OAG 2-58 Attachment 6.

underlying reasons supporting my long-term incentive adjustment have not changed.

Q. WILL YOU SUMMARIZE ADJUSTMENT OAG-5-BCO (REVISED EXHIBIT BCO-2, SCHEDULE A-8)?

A. This expense adjustment of $582,228 (and corresponding adjustment to reduced capitalized long-term incentive costs by $391,201) removes one-half of the long-term incentive pay (direct and allocated) which are paid to officers and management because this compensation is awarded for meeting longer term shareholder-driven goals instead of goals that are related to ratepayer interests (such as incentives tied to goals related to customer satisfaction, safety, service quality, customer service, improved billing procedures, etc.). I am not proposing that Atmos withdraw these incentive plans or stop making these long-term incentive payments to employees, I am merely proposing that these amounts be removed for regulatory purposes, similar to the justification for other regulatory-proposed adjustments. I proposed this adjustment and the same rationale for long-term incentives, and it was adopted by the Public Service Commission of Maryland ("Maryland Commission") in a prior rate case, and the Maryland Commission has also adopted this same adjustment policy for other energy companies that it regulates. This adjustment is

reasonable and will promote equitable treatment between ratepayers and shareholders.

Q. WILL YOU EXPLAIN IN MORE DETAIL HOW ATMOS' LONG-TERM INCENTIVE PLANS ARE TIED MORE CLOSELY TO LONGER TERM SHAREHOLDER-DRIVEN GOALS INSTEAD OF GOALS TIED TO RATEPAYER INTERESTS?

A. Yes. Atmos offers the following incentive plans:

1) Long-Term Incentive Plan ("LTIP") for the Management Committee, Corporate Officers, and Directors and Managers in pay grades 7 and above (OAG 2-61).
2) Management Incentive Plan ("MIP") for Management Committee, Corporate Officers, and Directors and Managers in pay grades 7 and above (OAG 2-60).
3) Variable Pay Plan ("VPP") for employees in grades 1 through 7 (OAG 2-58).

Although each of these long-term incentive plans vary to some degree among the employees to which they are offered or how they are paid, but each plan awards incentives based on a performance measure of the Earnings Per Share ("EPS"). In other words, Atmos' actual achieved EPS is measured against pre-established targets or criteria, and employees are paid an incentive award based on a sliding scale of how the Company performed against the EPS incentive goals or targets. The Company does not have to meet the "maximum" EPS target for employees to be paid an incentive award, but the higher the actual EPS (and the closer it is to the

maximum EPS target), the greater the amount of incentive award that is paid to employees.

The EPS target is considered a "longer-term target/goal" even if it is awarded every year, and EPS is tied more closely to shareholder interests than it is to ratepayer interests. This is because shareholders will benefit more directly and significantly if and when a higher EPS is achieved via increased stock price, increased dividends, and long-term stability in all of these. All of the previously mentioned incentive plans promote achieving a higher EPS, and so shareholders will be the primary beneficiary of increased EPS over time.[21] In fact, any type of LTI target or goal that is primarily financial results-driven will provide more benefits to shareholders and the Maryland Commission supported this rationale in a prior decision removing 50% of LTI expense. I do agree that ratepayers will receive some residual benefit from increased EPS over time, but not to the extent that shareholders will benefit.

None of these incentive plans appear to have specific targets or goals that would be more customer/ratepayer focused and provide more direct benefits to ratepayers, such as improved customer satisfaction, improved

[21] Arguably, a shareholder that is also a ratepayer would stand to benefit also.

service quality, improved safety, improved customer service, improved billing procedures, and other customer-driven measures.

Because the incentive plans that I mentioned are focused more on shareholder-driven EPS goals (and financial results), I propose that the costs of long-term incentives be shared equally between shareholders and ratepayers, and that one-half of these incentives be disallowed or removed to below-the-line operations of Atmos.

Q. CAN YOU PROVIDE A CITE TO ANOTHER REGULATORY COMMISSION THAT HAS ADOPTED THE SAME ONE-HALF DISALLOWANCE (OR 50% SHARING) THAT YOU RECOMMEND IN THIS RATE CASE?

A. Yes, Washington Gas Light Company ("WGL") filed a rate case in Case No. 9267 before the Maryland Commission.[22] In that proceeding, I filed direct testimony proposing a 50% percent disallowance or sharing of the long-term incentive ("LTI") expense, and I subsequently amended by testimony to support a 75% exclusion of the LTI based on unique circumstances in that case. The Commission adopted a 50% disallowance of the LTI and stated that it agreed with the Hearing Examiner's decision

[22] *In the Matter of the Application of the Washington Gas Light Company for Authority to Increase its Existing Rates and Charges and to Revise its Terms and Conditions for Gas Service*, before the Maryland Commission, Case No. 9267, Order No. 84475, issued November 14, 2011 ("WGL rate case").

in the prior WGL rate case to disallow 50% of the LTI, when the Hearing Examiner stated:

> it is unreasonable for ratepayers to fund the total increase in incentive compensation in this instance, which appears to be a result of the Company reaching a rate of return threshold, and due to an accounting change for stock options which are primarily tied to the Company's financial goals.[23]

The Maryland Commission's Order in the WGL rate case also stated the following regarding the 50% disallowance of the LTI:

> Based upon the record in this proceeding that LTI pay is based solely upon shareholder interests, the Commission concludes that it is appropriate to allow recovery of only one-half of LTI compensation in cost of service, which is consistent with our decision in WGL's last base rate case. Therefore, we exclude $1,201,138 of LTI pay for total reduction in incentive compensation of $1,762,398 ($1,201,138 + $561,260) from the Company's operating expenses, which translates into a net of tax increase in operating income of $1,051,050.[24]

Q. ARE YOU AWARE OF ANY UNIQUE REASONS FOR NOT ADOPTING THE 50% DISALLOWANCE IN THIS RATE CASE?

A. No.

[23] *Id.* WGL rate case, page 28.
[24] *Id.* WGL rate case, page 30.

ADJUSTMENT OAG-6-BCO – REMOVE INCREASED COSTS OF "SINGLE GO-LIVE" CSS IMPLEMENTATION DECISION, UNTIL EFFICIENCES ARE REFLECTED IN RATE CASES IN FUTURE YEARS

Q. WILL YOU SUMMARIZE ADJUSTMENT OAG-6-BCO (EXHIBIT BCO-2, SCHEDULE A-9)?

A. This adjustment reflects cost savings due to the implementation of the new CSS, including cost savings previously reported to the Board of Directors by Atmos. This adjustment reflects cost savings via a reduction in operating expenses of **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** and via an adjustment to reduce CSS capital costs **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL.**

Q. WILL YOU EXPLAIN ATMOS' DECISION TO CHANGE ITS CSS IMPLEMENTATION APPROACH?

A. Mr. Martin's testimony briefly addresses the new Customer Service System (CSS), but does not explain Atmos' decision to change its implementation approach for the CSS. Atmos' responses to various OAG data requests indicates that the Company changed its deployment strategy from using a <u>two-stage</u> "go-live" (implementation) to a <u>single stage</u> go-live implementation of the new CSS. Atmos' response to OAG 1-

97 states that the original cost of a two-stage CSS implementation was estimated at $64 million (total system, not Kentucky allocated) and this increased by about $8 million, to a cost estimate of $72 million with the decision to adopt a single stage CSS implementation. However, the final actual costs of the single stage implementation increased by about $6.9 million, to an amount of $78.9 million due to the addition of internal resources for testing the system prior to final go-live implementation.

Q. WHY ARE YOU PROPOSING ADJUSTMENTS RELATED TO THE CSS IMPLEMENTATION?

A. I am proposing this two-part adjustment for two primary reasons:

1) Cost Savings Originally Identified by Atmos but Not Included in this Rate Case - To reflect estimated efficiencies and cost savings related to the new CSS system based on estimates originally provided at Board of Directors meetings, and which have not been included in this rate case by Atmos (although other arbitrary and unproven cost increases have been included in this rate case).

2) Share Increased Costs from 2-Stage to Single-Stage Approach - Atmos must have anticipated certain quantitative and qualitative benefits related to the implementation under the single stage approach (versus the 2-stage approach), and these benefits should be shared with ratepayers (thus, the 50% share of the excess costs related to single-stage implementation).

Q. HOW DID YOU DETERMINE THE FIRST PART OF YOUR ADJUSTMENT TO CSS?

A. OAG 1-97 asked Atmos to provide forecasted costs and efficiencies of CSS, and to compare original forecasted costs to actual costs and explain the reasons for variances. Atmos' response provided Confidential Attachment 1 as a copy of a presentation made to the Board of Directors on August 4, 2010 which showed total annual estimated O&M savings related to CSS of **BEGIN CONFIDENTIAL** [redacted] for 2013, [redacted] for 2014, and [redacted] for 2015. I used the 2015 savings of [redacted] **END CONFIDENTIAL** and calculated a ratio of this savings to Atmos' original capital spend of $47 million, and then I applied this ratio to Atmos' updated capital spend of $78.9 million. This calculation is shown at Exhibit BCO-2.

Q. HOW DID YOU DETERMINE THE SECOND PART OF YOUR ADJUSTMENT FOR CSS SAVINGS?

A. I am proposing to at least temporarily remove costs related to one-half of the difference between the original 2-stage CSS costs of $64 million and the final actual single-stage CSS costs of $78.9 million, so the total cost increase of $14.9 million will be cut in half to $7.45 million (this amount also approximates the $8 million increase in original estimated costs from the 2-stage CSS costs of $64 million to the single-stage CSS costs of $72 million, and this rationale can also be used regarding this adjustment). In

addition to removing the capital costs of about $7.45 million, I am also removing the related depreciation expense on these capital costs. On an Atmos Kentucky allocated basis, this adjustment will temporarily reduce CSS capital costs **BEGIN CONFIDENTIAL** [redacted] and temporarily reduce depreciation expense [redacted] **END CONFIDENTIAL.**

ADJUSTMENT OAG-7-BCO – REMOVE NET OPERATING LOSS CARRYFOWARD TAX BENEFIT AMOUNT FROM ACCUMULATED DEFERRED TAXES ("NOLC ADIT")

Q. WILL YOU SUMMARIZE ADJUSTMENT OAG-7-BCO (EXHIBIT BCO-2, SCHEDULE A-10)?

A. I have reduced rate base by an amount of $22,221,329 related to a NOLC ADIT tax benefit which has the impact of increasing rate base for the accumulated deferred tax impact calculated on book-tax timing differences that cause a loss on the income tax return. I was only able to calculate an estimate of this amount, and my adjustment may be understated. This amount should be removed from rate base and will not cause any tax normalization violations. If there is substantive disagreement on this issue, then I recommend that Atmos seek a private

letter ruling with the Internal Revenue Service on this issue to resolve the matter.

Q. WHAT IS A NET OPERATING LOSS CARRYFORWARD ACCUMULATED DEFERRED INCOME TAX BALANCE "NOLC ADIT"?

A. I will use the term NOLC ADIT to refer to the accumulated deferred tax impact (which is the "debit" amount netted with the typical "credit" amounts included in the accumulated deferred income tax account) recorded on tax timing differences that are causing a loss for income tax purposes, and this primarily consists of bonus depreciation, capitalized overheads, and repair allowances. I am most concerned with removing the NOLC created by tax bonus depreciation that is causing an income tax loss. Typically accumulated deferred income taxes include the tax impact of depreciation timing differences for income taxes, and this is recorded as a credit amount and is used as an offset to rate base. I do not have any concerns regarding these amounts. However, a NOLC is the opposite, it is the deferred tax impact recorded mostly due to bonus depreciation timing differences (and other timing differences) that are causing a loss for income tax purposes. This amount is included as debit (or "deferred tax

asset") as an offset to the typical credit balance in the accumulated deferred income tax account and it causes an increase in rate base.

Q. HOW DID YOU IDENTIFY THE NOLC ADIT ON ATMOS' BOOKS?

A. OAG 2-78 referred to Staff 1-47 and asked Atmos to identify all NOLC ADIT amounts included in this rate case by account and how it has been treated in this rate case. Atmos' response states that it has generated tax losses on all tax returns for tax years ended September 30, 2008 through September 30, 2012, and some of these net operating losses have been carried back with the remainder being carried forward, including amounts for September 30, 2010 through September 30, 2012. Atmos states that it included a NOLC ADIT through the forecasted test period March 31, 2013, in this rate case. Atmos' response to AG 2-78 refers to the responses of OAG 1-47 and Staff 1-59 as including workpapers and amounts showing the NOLC ADIT in accounts 1900 and 2820. However, Atmos did not specifically provide the Kentucky portion of NOLC ADIT[25] included in the forecasted test period and did not specifically explain which amounts from the workpapers represent the NOLC ADIT amounts. I have prepared a workpaper and calculation included at Exhibit BCO-2

[25] The response to OAG 2-78 did identify a NOLC ADIT amount of $340,724,523 prior to any allocation.

related to my adjustment to remove the NOLC ADIT. I used my best efforts to determine the NOLC ADIT amounts from the cited workpapers and data requests, but I may have understated the amount. I am removing an estimated NOLC ADIT of $22,221, 329 from this rate case, and this will cause rate base to decrease by this amount.

Q. DID YOU REMOVE OR REDUCE INCOME TAX EXPENSES ALSO?

A. No, although an argument can be made for reducing income tax expense as part of the NOLC ADIT adjustment. I am only removing the NOLC ADIT from rate base and I am not proposing any adjustments to income tax expense.

Some utilities will argue that any adjustments to remove the NOLC ADIT or to reduce income tax expense will cause a tax normalization violation of the tax code. However, in another rate case where I participated on behalf of the Kentucky Office of Attorney General, Big Rivers Electric Corporation ("BREC") had a NOLC ADIT and volunteered to reduce its state and federal income tax to zero.[26] In the BREC rate case, my direct testimony explains that BREC has a NOLC ADIT of $30.1 million, and because it can use this amount to carry-forward and offset against future

[26] *In the Matter of: Application of Big Rivers Electric Corporation for a General Adjustment in Rates,* Commonwealth of Kentucky, Before the Public Service Commission of Kentucky, Case No. 2012-00535.

federal and state income taxes, BREC did not include any amounts for federal or state income tax expense in its rate case because the Company will not incur or pay any federal or state income taxes for the foreseeable future.[27] Thus, I do not believe that removing a NOLC ADIT or reducing income tax expense related to this same issue will cause a tax normalization adjustment because I do not think that BREC would voluntarily put itself in a position to be in violation of the tax code.

Q. WILL A TAX NORMALIZATION VIOLATION OCCUR IF A REGULATORY ADJUSTMENT IS MADE TO REMOVE THE NOLC ADIT IN A RATE CASE?

A. No. A tax normalization violation would typically occur if a company failed to be compliant in recording deferred income taxes on depreciation book-tax timing differences in some manner under the conventional method of recording deferred income taxes, a tax normalization violation in this sense only relates to "depreciation" related timing differences and not to any other tax timing difference or issue. However, a tax normalization violation will not result from removing the NOLC ADIT in a rate case. Internal Revenue Code §168(i)(9) and Treasury Regulations §1.167(l)-1(h)(1)(b)(iii) and §1.167(l)-1(h)(6)(i) do not specifically require a

[27] Bion C. Ostrander, Direct Testimony, Case No. 2012-00535, May 24, 2013, p. 71, lines 2-16.

NOLC ADIT to be included in rate base in a rate case and do not state that the failure to include a NOLC in rate base for regulatory purposes is a tax normalization violation. Treasury Regulation §1.167(l)-1(h)(1)(b)(iii) makes limited reference to a "net operating loss carryover", but then merely indicates that the "amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director." To the best of my knowledge, Atmos has not sought or received any direction from the district director regarding the treatment of a NOLC ADIT. Also, Treasury Regulation §1.167(l)-1(h)(6)(i), refers to the maximum amount of the deferred tax reserve that is to be "excluded from the rate base" (or to be included as no-cost capital) and this applies to the typical recording of the accumulated deferred income tax as a liability amount, but this section of Treasury Regulation is not applicable to the NOLC ADIT which is "included in the rate base" (and is not excluded from rate like the typical credit balance accumulated deferred income taxes).

Furthermore, Treasury Regulation §1.167(l)-1(a)(1) only relates to federal tax normalization and does not require tax normalization of book-tax timing differences for state purposes. Therefore, at the very minimum,

Atmos' inclusion of an NOLC ADIT for state purposes can be removed from this rate case without any tax normalization based on Treasury Regulations.[28]

Q. ARE YOU AWARE OF ANY SINGLE CASE WHERE A STATE UTILITY REGULATOR'S FAILURE TO INCLUDE A NOLC ADIT IN RATE BASE CAUSED A TAX NORMALIZATION VIOLATION FOR A COMPANY?

A. No.

Q. ALTHOUGH YOU ARE NOT AWARE OF ANY ACTUAL TAX NORMALIZATION VIOLATIONS THAT HAVE OCCURRED RELATED TO A NOLC ADIT, HAVE REGULATORY AGENCIES COME DOWN ON BOTH SIDES OF THIS ISSUE?

A. Yes, there are citations both directions, some state regulatory agencies have removed NOLC ADIT from rate base in a rate case and some have required inclusion of the NOLC ADIT in rate base.

[28] I have not fully researched Kentucky state tax law regarding NOLC ADIT, but it is possible that state tax makes it appropriate to record a NOLC ADIT for "state" income tax purposes.

Q. CAN YOU EXPLAIN IN MORE DETAIL THE WEST VIRGINIA COMMISSION'S DECISION IN THE MOUNTAINEER GAS CASE TO REMOVE NOLC FROM RATE BASE, AND ITS DETERMINATION THAT THIS DOES NOT CAUSE A TAX NORMALIZATION VIOLATION?

A. Yes. The West Virginia Commission denied Mountaineer Gas' proposal to include a NOLC in its rate base in three consecutive orders (including the original order and two subsequent requests for reconsideration) dated October 31, 2012, February 11, 2013, and April 9, 2013. In response to the two reconsideration requests the West Virginia Commission re-affirmed its original position and stated that a NOLC can be excluded from rate base without causing a tax normalization violation. This case is current and applicable to the same issues in this Atmos case.

Mountaineer Gas included net operating loss carryforwards (identified as "NOLs") as an increase to its rate base and made some of the same arguments as other utilities have made by stating that failure to include these amounts in rate base would cause a tax normalization violation. In its original October 31, 2012 Order, the West Virginia Commission stated

that Mountaineer could not offset the NOLs against the ADIT and reduce rate base:[29]

> The Commission has thoroughly considered this issue and will deny Mountaineer's proposed $11.4 million reduction in its plant-related ADIT liability balances. The treatment of the $11.440 million reduction proposed by Mountaineer effectively creates an offsetting regulatory asset to the ADIT balance which the Commission specifically rejected in the January 17, 2012 Order in Bluefield, Case No. 11-0410-G-42T.[30]

Also, the West Virginia Commission stated:

> Recording the future federal income tax liability related to temporary depreciation timing differences in the year in which the timing differences occur is not incorrect nor does it in any way violate the tax statutes or IRS regulations.[31]

In its subsequent February 11, 2013, Order issued on reconsideration, the West Virginia Commission re-affirmed its previous position and stated:[32]

> 1. The Commission's decision regarding ADITs and the Minimum Adjustment, as explained in the November 2012 Order, was supported by the record in this case, is reasonable, and was fully and adequately addressed in that Order.

[29] West Virginia Commission, page 17, dated October 31, 2012. The West Virginia Commission does indicate that it will not adopt "normalization accounting" for "state" income tax purposes, but it does not indicate that its decision to disallow NOLs is a violation of "federal" tax rules regarding normalization.
[30] Id., page 16.
[31] Id., page 16 and page 54, Conclusion of Law, item 12.
[32] West Virginia Commission, page 8, Conclusions of Law, items 1 and 2, Order dated February 11, 2013.

2. The Commission is not persuaded by the Mountaineer arguments that its treatment of ADITs and current deferred income tax expense used in setting the Company rates in the November 2012 Order is unreasonable or creates a normalization violation. (Emphasis added).

Finally, on April 9, 2013, the West Virginia Commission issued is latest and third order, responding to the second reconsideration request of Mountaineer Gas. Again, the West Virginia Commission reaffirmed the decision to remove the NOL from rate base and stated that this does not cause a tax normalization violation.[33]

Q. CAN YOU DISCUSS THE PLR ISSUE IN THE MOUNTAINEER GAS CASE?

A. Mountaineer Gas' second reconsideration request asked the West Virginia Commission to order the utility to get a Private Letter Ruling ("PLR"), but the Commission declined, and said that the decision to seek a PLR is one to be made by Mountaineer.[34]

[33] West Virginia Commission, page 9, Conclusions of Law, items 1, 2, 3, 4, 5, 6 and 7, Order dated April 9, 2013.
[34] West Virginia Commission, Conclusions of Law, p. 8, Order dated February 11, 2013.

Q. IF THERE IS SUBSTANTIVE DISAGREEMENT ON THE NOLC ADIT ISSUE WITH ATMOS, WOULD YOU RECOMMEND THAT ATMOS OBTAIN A PRIVATE LETTER RULING TO RESOLVE THIS ISSUE?

A. Yes, I believe a private letter ruling may be the only reasonable manner to resolve this issue between parties with significant differences of opinion.

Q. IS ATMOS' FORECASTED TAX LOSS THAT IS USED TO CALCULATE A NOLC ADIT FOR 2013 CONSIDERED TO BE "KNOWN AND MEASURABLE"?

A. No. Atmos admits that it included a projected NOLC ADIT in rate base for at least part of 2013 (and perhaps through 2014), although I was not able to determine this precise amount. A NOLC ADIT only results from an income tax loss, and it is not possible to know if Atmos will have a tax loss for years 2013 and 2014 until it finalizes and formally files its federal income tax return. A company cannot deduct accelerated tax depreciation on its books until the year of that depreciation and any attempt to take the benefit of tax depreciation in advance would constitute a tax normalization violation. Furthermore, a company cannot be subject to a tax normalization violation for not seeking recovery of NOLC ADIT's in forecasted test periods in rate cases, and this is because a tax loss cannot

be reasonably known and measured until the actual income tax return is filed.

Q. WHAT ARE YOUR CONCLUSIONS REGARDING THE NOLC ADIT ISSUE?

A. All NOLC ADIT balances should be removed from this rate case and this will not cause any tax normalization violation, and there is no proof that this type of regulatory adjustment has ever caused a tax normalization violation in any rate case.

ADJUSTMENT OAG-8-BCO – REDUCE BAD DEBT EXPENSE FOR ATMOS' ERROR

Q. WILL YOU SUMMARIZE ADJUSTMENT OAG-8-BCO?

A. This adjustment reduces bad debt expense by $25,048 for an error admitted by Atmos in its response to OAG 1-152.

Q. DO YOU SUPPORT ANY INCREASES IN RATE CASE EXPENSE BEYOND THE AMOUNT INCLUDED IN ATMOS' ORIGINAL APPLICATION?

A. No. I believe the amount of rate case amortization expense that is the lesser of actual amortization expense or the estimated three-year

amortization expense of $105,667 (included in the original Application) is adequate.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

EXHIBIT

E

BEFORE THE PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY

APPLICATION OF ATMOS ENERGY	)	
	)	
CORPORATION FOR AN ADJUSTMENT	)	**Case No. 2013-00148**
	)	
OF RATES AND TARIFF MODIFICATIONS	)	

REBUTTAL TESTIMONY OF PACE MCDONALD

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.

A. My name is Pace McDonald. I am Vice President of Taxes for the Atmos Energy Corporation and Subsidiaries ("Atmos Energy" or the "Company"). My business address is 5430 LBJ Freeway, Suite 600, Dallas, Texas 75240.

Q. WHAT ARE YOUR JOB RESPONSIBILITIES?

A. I am responsible for oversight and management of all income, property and sales tax matters for the Company. This oversight includes ensuring that the tax accounts recorded on the books and records accurately reflect the Company's tax filings and positions. I oversee a group of 23 tax professionals and clerical staff which undertake tax planning to minimize taxes, prepare the Company's tax filings, and defend those filings under audit. I am also responsible for the establishment and compliance with the Company's tax policies and controls.

Q. PLEASE OUTLINE YOUR EDUCATIONAL AND PROFESSIONAL QUALIFICATIONS.

A. I received my education at the University of Texas at Austin. In 1993, I concurrently received a Bachelor of Business Administration degree with a major in accounting and a Master of Professional Accounting degree with a specialization in tax. I am a licensed certified public accountant in the State of Texas.

I began working for the public accounting firm of Deloitte & Touche LLP in August 1993. In 1997, I left Deloitte & Touche LLP and joined the public accounting firm of Ernst and Young LLP. At both firms, I provided tax planning and compliance services to a client base of primarily large public companies. My client base was equally divided between large multinational manufacturers and regulated public utilities. One of my key responsibilities included reviewing and consulting with clients regarding the appropriate amount and manner in which to record accumulated deferred income taxes.

In April 2002, I joined Atmos Energy Corporation and assumed the oversight and management of all income, property and sales tax matters for the Company. I also serve as the Company's representative on the American Gas Association's Tax Committee.

Q. HAVE YOU TESTIFIED BEFORE ANY OTHER REGULATORY COMMISSIONS?

A. Yes. I testified before the Railroad Commission of Texas in GUD Nos. 9670, 9762, 9869, 10000 and 10170. I have also testified before the Public Service Commission of Mississippi in Docket No. 92 UN 0230.

Q. WHAT WAS THE SCOPE OF YOUR TESTIMONY IN THOSE PROCEEDING?

A. I provided rebuttal testimony regarding the Company's accumulated deferred income taxes ("ADIT") and the appropriateness of including specific ADIT items within the rate base as filed in those proceedings.

Q. HAVE YOU REVIEWED THE INTERVENOR TESTIMONY FILED IN THIS CASE?

A. Yes, I have.

II. PURPOSE AND SUMMARY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I rebut the arguments raised in the direct testimony of Kentucky Office of the Attorney General witness Bion C. Ostrander regarding his proposed adjustments to accumulated deferred income tax ("ADIT") for tax net operating loss carryforwards ("NOLC"). I will address what gives rise to NOLC ADITs as well as the regulatory treatment of this item.

Q. PLEASE SUMMARIZE YOUR IMPRESSIONS OF MR. OSTRANDER'S TESTIMONY.

A. Mr. Ostrander has incorrectly proposed to eliminate from rate base the NOLC ADIT asset. Mr. Ostrander's direct testimony incorrectly presumed that the Company's sole argument for including the NOLC ADIT asset in rate base was to avoid a normalization violation as defined under the Internal Revenue Code ("IRC"). Upon reading his testimony it is apparent that his sole argument for

removing the NOLC ADIT asset is because he does not believe it will cause a normalization violation as defined in the IRC and related regulations.

I am unable to find a single argument in his testimony as to why it is appropriate under general ratemaking principles to remove the NOLC ADIT asset. His testimony does not describe ADIT assets and liabilities and why they are adjustments to rate base. He fails to establish that rate base will be more accurately reflected by its removal. In fact, he offers no such opinion. He instead spends a considerable amount of testimony opining incorrectly that its removal would not be a normalization violation under the IRC.

It will be my testimony that inclusion of the NOLC ADIT asset is an appropriate adjustment to rate base accepted by numerous commissions and is based first and foremost on sound ratemaking principles. Failure to make the adjustment would result in a rate base and an associated return requested from rate payers that would not be reflective of the economic realities embodied in the Company's tax filings and associated cash flow.

I will also address his assertion that removal of the NOLC ADIT asset would not violate the normalizations provisions of the IRC. My testimony will demonstrate that failure to include the NOLC ADIT asset would in fact result in a normalization violation. Mr. Ostrander's testimony, to the contrary, is incorrect. Further, his suggestion that a private letter ruling from the IRS is the only mechanism to support including the NOLC ADIT asset in rate base is misleading.

Finally, Mr. Ostrander's testimony that a NOLC must be reflected on a tax return to be known and measurable is incorrect and not consistent with his acceptance of other ADIT adjustments.

Q. PLEASE SUMMARIZE YOUR TESTIMONY REGARDING THE PROPER RATEMAKING TREATMENT OF NOLC ADIT ASSETS..

A. In this filing, the Company's requested rate base has been reduced by its net ADIT liability balance. Embedded within the ADIT liability balance is an asset (increase to rate base) for NOLCs.

ADIT liabilities are realized because the Company's tax filings reflect tax deductions in excess of its 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. As more fully explained in my testimony, this cash tax savings allowed by the government represents an interest free loan from the government to the Company. The loan is paid back over time as the Company's book deductions exceed its tax deduction. Essentially an ADIT liability represents an obligation to pay this interest free loan back to the government in the future. These loans are therefore appropriately reflected as a reduction to rate base to account for this cost free capital provided to the Company.

In certain situations, the Company's tax deductions can produce a tax net operating loss. A tax net operating loss is realized when the Company' tax deductions exceed its earned income and all tax has been offset. Tax in future periods will be offset by the unused deductions. These unused tax deductions are

reflected on the Company's tax returns and books and records as a carryforward of the net operating loss. These carryforwards (NOLC) are used in future periods to offset tax. In effect, a NOLC represents tax deductions that have not yet been used to offset tax. Since those deductions have not yet been used offset tax, the government has not yet extended an interest-free loan to the Company. It follows that the Company's rate base should not be reduced for cost free capital that it has not yet realized.

It is my testimony that all of the ADIT balances, assets and liabilities, must be included in the calculation of the ADIT rate base reduction. The NOLC ADIT asset must be included otherwise the Company's rate base does not reflect the true quantity of interest free cash made available to the Company by the government.

Q. PLEASE SUMMARIZE YOUR TESTIMONY AS TO WHETHER NORMALIZATION OF NOLC ADIT ASSETS IS REQUIRED BY THE IRC.

A. A violation of the tax depreciation normalization provisions is a serious matter under the IRC and a violation would have devastating financial implications. Mr. Ostrander's arguments are dangerous and misguided. There is no doubt normalization is required of NOLC ADIT assets. Despite Mr. Ostrander's attempts to confuse the issue with suggestions of private letter rulings and citations of two unpersuasive rulings, it is unambiguous and clear the IRC and Treasury Regulations require the normalization of NOLC ADIT assets. Mr. Ostrander's argument that a normalization violation has never been asserted by

the IRS is an argument in the negative and not persuasive. It could also be said that the lack of documented normalization violations is proof in and of its self that Commissions are thoughtful and deliberate in avoiding such a violation by including NOLC ADIT assets in rate base.

Q. PLEASE SUMMARIZE YOUR TESTIMONY AS TO WHETHER A PROJECTED NOLC ADIT ASSET IS KNOWN OR MEASURABLE.

A. Mr. Ostrander proposes to limit the NOLC ADIT asset to that which has been reported on a tax return. A Company routinely estimates and projects its taxable position throughout the year. This is done for estimated tax payments and the recording of financial results. The filing of a tax return is a ministerial act that is often done months after the covered tax period. To require the filing of a tax return before the inclusion of ADIT items in rate base would result in the mismatching of the tax effects from rate base investment and cost of service expenses. Further, Mr. Ostrander suggests limiting only the projected NOLC ADIT asset. He makes no mention or suggestion of limiting the projected ADIT liabilities. It cannot reasonably be argued to limit increases to rate base for NOLC ADIT assets from filed tax returns, yet allow the decreases to rate base for projected ADIT liabilities. The inequity of such a suggestion is startling.

Q. ARE YOU SPONSORING ANY EXHIBITS?

A. Yes, I am sponsoring Exhibit PM-1.

Q. WERE THESE EXHIBITS PREPARED BY YOU OR UNDER YOUR DIRECT SUPERVISION?

A. Yes.

III. RATEMAKING TREATMENT OF ACCUMULATED DEFERRED INCOME TAXES

Q. DOES MR. OSTRANDER DESCRIBE WHAT GIVES RISE TO ACCUMULATED DEFERRED TAXES OR THE IMPORTANCE OF THOSE DEFERRED TAXES IN SETTTING RATE BASE FOR A REGULATED UTILITY?

A. No. Mr. Ostrander's testimony fails to either describe or mention the importance of accumulated deferred taxes.

Q. WHY IS AN UNDERSTANDING OF ACCUMULATED DEFERRED TAXES IMPORTANT IN THIS PROCEEDING?

A. Understanding what accumulated deferred taxes represent is critical in understanding the impact accumulated deferred taxes have on a Company's financing and how that should be accounted for in ratemaking.

Q. PLEASE DESCRIBE WHAT ACCUMULATED DEFERRED INCOME TAXES ARE.

A. Deferred taxes represent the balance of tax that is due or receivable in the future when items of items of income and expense are recognized for tax purposes in a period different than they are recognized for financial reporting purposes. Accumulated deferred taxes simply represent the accumulated tax for all items deferred to future periods. More importantly, for a regulated utility, deferred taxes represent a source of cost-free financing provided by the government.

Q. PLEASE DESCRIBE WHAT GIVES RISE TO ACCUMULATED DEFERRED INCOME TAXES.

A. Deferred taxes arise from the interaction of the IRC, the Company's accounting practices under United States ("US") generally accepted accounting principles ("GAAP"), and the Company's operations. Deferred taxes are created because of differences between the IRC and the Company's accounting under US GAAP. In addition to FERC rules, the Company's records are maintained according to US GAAP accounting principles which provide guiding principles and requirements as to when and how the Company records its financial results. Likewise, the IRC and related regulations provide the rules and requirements the Company follows when completing its tax filings. There are a myriad of differences between US GAAP and the IRC.

Examples include but are not limited to differences in the recognition of income or expense, time period or methods by which assets are depreciated and the capitalization of costs. Many of these differences are temporary in nature, meaning the total amount of income or expense recognized for an item is the same under US GAAP and the IRC, but the time period over which it is recognized is different. For example, an item purchased by the Company for $100 may be capitalized and depreciated over a 30 year period under US GAAP. The IRC may permit that same item to be depreciated over a 15 year period. There is no difference in the depreciation deductions over time in that US GAAP and the IRC permit the Company a $100 depreciation deduction. However, that deduction is realized over different time periods. It is this difference in timing between the US GAAP and the IRC that give rise to deferred taxes. Due to the difference in timing

required by the IRC, the Company has deferred recognition of tax liabilities or benefits to a future period.

Q. WHAT IS THE MOST SIGNIFICANT DRIVER OF UTILITY ACCUMULATED DEFERRED TAXES?

A. Timing differences between book and tax depreciation associated with utility property and plant. Notably, the difference between much slower book depreciation versus the accelerated or bonus tax depreciation allowed under the IRC.

Q. HOW DO DEFERRED TAXES IMPACT A REGULATED UTILITY?

A. A utility earns its allowed rate of return and cost of service from its rate payers. A component earned includes the tax liability the utility will owe on its earnings. From its earning, the utility has cash funds available to pay its tax obligations to the government. However, the federal government by way of accelerated and bonus depreciation rules grant the utility tax depreciation in excess of its book deprecation. These favorable depreciation deductions lower the utility's current tax liability and provide funds to the utility in the current period. However, its future tax liability will be increased and those funds will be remitted to the government in the future. The net effect is that the government has provided an interest-free loan to the utility by virtue of a lower current tax bill due to the accelerated and bonus depreciation provisions. That interest-free loan will be repaid by higher tax bills in the future.

Q. HOW IS THIS LOAN REFLECTED ON A UTILITY'S BOOKS AND RECORDS?

A. Essentially, the balance of the interest-free loan is reflected as the net ADIT credit recorded on the Company's books and records. An ADIT credit is quite simply the amount of interest-free capital that the government loaned to the Company.

Q. HOW IS AN ADIT CREDIT TREATED FOR RATEMAKING PURPOSES?

A. Given that an ADIT credit represents an interest free loan or cost-free capital, rate base should be reduced for the amount of the ADIT credit. This allows rate payers to receive the benefit of the interest-free loan and not pay a rate of return on rate base financed at no cost.

Q. IS THE REDUCTION OF RATE BASE FOR ADIT CREDITS A STANDARD REGULATORY RATEMAKING PRACTICE?

A. Yes. This is the widely accepted treatment of ADIT credits.

IV. NET OPERATING LOSS CARRYFORWARDS

Q. WHAT IS A NET OPERATING LOSS ("NOL")?

A. The Company computes it taxable income in accordance with the IRC. Depending on the income and deductions reported on the Company's tax return, either a positive or negative taxable income is reported on the tax return. A positive taxable income will result in the imposition of tax at the applicable tax rate. A negative taxable income creates an income tax net operating loss ("NOL").

Q. WHAT IS AN INCOME TAX NET OPERATING LOSS CARRYFORWARD?

A. Under §172 of the IRC, a tax NOL may first be carried back to offset taxable income (generally to the two preceding years). Any loss remaining after the carryback is available to carry forward for up to 20 years and reduce taxable income in a future period.

Q. WHAT ARE THE CONSEQUENCES OF CARRYING AN NOL FORWARD?

A. An NOL carryforward is simply deductions that were claimed on a prior tax return but not used to offset the tax liability in the period claimed. An NOL carryforward therefore has the effect of moving those unused deductions forward to a subsequent year to offset the tax liability of the future period.

Q. HAVE ATMOS ENERGY CORPORATION'S REGULATED UTILITY OPERATIONS RESULTED IN TAXABLE LOSSES?

A. Yes. For the past six fiscal years, the taxable income computations for the utility operations have reflected large taxable losses.

Q. HAVE THESE LOSSES RESULTED IN A NOL CARRYFORWARD FOR THE COMPANY?

A. Yes. As of the filing of this case, the Company had a federal and state NOL carryforwards of $340,724,523 and $2,430,678, respectively, from its utility operations.

Q. HAS THE COMPANY PROPOSED TO INCREASE RATE BASE FOR THESE AS NOLC ADIT ASSETS?

A. Yes. The Company has proposed to increase rate base for the proportionate share of these items allocable to Kentucky consistent with the Company's cost allocation manual.

Q. PLEASE EXPLAIN WHAT CAUSED THE TAX LOSSES AND NOL CARRYFORWARD.

A. The Company has realized significant deductions associated with bonus depreciation, accelerated depreciation and the deduction of capital expenditures as repairs for tax purposes.

Bonus depreciation is a stimulus measure passed by Congress that allows taxpayers to immediately expense a portion of costs that would normally be a capital expenditure subject to recovery over an extended period through depreciation deductions. The percentage of capital expenditures deductible for calendar years 2009-2013 has either been 50% or 100%, depending on the time period and type of assets. Effectively, bonus depreciation has allowed the Company to expense immediately either 50% or 100% of most capital investment since 2009.

Accelerated depreciation is another depreciation methodology allowed under the IRC whereby taxpayers are allowed to depreciate assets on a much faster basis than that allowed for financial accounting or regulatory purposes. In the early years of an asset's life, tax depreciation (accelerated depreciation) is typically higher than book depreciation (straight-line). This difference in depreciation methodologies produces more tax depreciation in the early years of an asset's life and less in future years. For that portion of capital investments not

expensed as bonus depreciation, the Company was permitted to claim depreciation deductions under the accelerated depreciation provisions.

The Company is allowed for tax purposes to treat certain types of otherwise capital costs as deductible repairs and maintenance costs. Rather than recording these expenditures as capital additions to plant in service for tax purposes, the Company expenses these expenditures immediately. The amount of costs eligible for immediate expensing as a repair has been substantial in recent years.

Q. DID THESE DEDUCTIONS HAVE AN IMPACT ON THE COMPANY'S ADIT BALANCE?

A. Yes. These accelerated deductions resulted in a deferral of the Company's tax liability. Therefore, an ADIT credit was recorded on the Company's books and records to reflect this future obligation to the government.

Q. WHAT THEN IS THE SIGNIFICANCE OF THE NOL CARRYFORWARD GENERATED BY THESE DEDUCTIONS?

A. To the extent that these deductions gave rise to an NOL carryforward, the deductions are not generating current tax savings. Therefore, in terms of the loan analogy described in my testimony, the government has not yet extended a loan because the underlying deductions have not yet reduced the Company's tax liability.

Q. HOW IS A NOLC REFLECTED IN THE COMPANY'S BOOKS AND RECORDS?

A. A NOLC is recorded as an ADIT asset. This asset represents a future cash flow from the government which will be realized when the Company has sufficient taxable income and a tax liability to reduce. Until that time, the tax deductions which have given rise to the NOL have not produced any tax saving for the Company

Q. HOW DOES THE RECORDING OF THE NOLC ADIT ASSET INTERACT WITH THE ADIT CREDIT RECORDED FOR ACCELERATED DEUCTIONS?

A. This asset effectively reduces the ADIT liability recorded for accelerated deductions to the amount that has been loaned to the Company in the form of current tax savings.

Q. WHAT IS THE SIGNIFICANCE OF THE NOLC FOR RATEMAKING?

A. The Company's ADIT credit balance represents the tax benefit of its favorable tax deductions regardless of whether or not they actually produced cash. A NOLC represents unused tax deductions beyond what is necessary to reduce current year taxable income to zero and taxes that the Company has on deposit with the government. There is no current cost-free capital associated with the NOLC, and thus, from a ratemaking perspective, it is inappropriate to have a reduction of rate base for the unused deferred taxes. Thus, the offset against rate base of accumulated deferred taxes must be limited to the amount of current benefit. The Company's proposed ratemaking treatment of including NOLs in rate base achieves this by accurately reflecting the cash tax savings obtained by the Company when these savings are realized.

Q. IS THERE ANY JUSTIFICATION FOR IGNORING THE IMPACT OF THE NOLC ADIT ASSET?

A. No, there is not. If the effect of the Company's NOLC is ignored, then every dollar of accelerated depreciation and other favorable tax deductions claimed by the Company on its tax returns would reduce its rate base - even though, to the extent the deductions simply produced a NOLC, they would not yet have deferred any tax and, therefore, would not have produced any incremental cash for the Company. If, instead, the Company had claimed fewer such deductions - only enough to eliminate its taxable income but not enough to produce a NOLC - then it would be in the same cash position (that is, the Company still would have paid $0 tax) but the amount by which its rate base is reduced would be diminished. Rate treatment that ignores the impact of the Company's NOLC would disadvantage the Company more so if it claimed favorable tax deductions than if it did not claim them.

Q. DOES MR. OSTRANDER OFFER ANY JUSTIFICATION BASED ON SOUND RATEMAKING PRINCIPLES FOR IGNORING THE IMPACT OF THE NOLC ADIT ASSET?

A. None, whatsoever.

V. NOLC REGULATORY PRECEDENT

Q. HAVE OTHER JURISIDCITIONS CONSIDERED THE NOLC ADIT ISSUE AND AGREED TO REGULATORY TREATMENT CONSISTENT WITH THAT PROPOSED BY THE COMPANY?

A. I am aware of decisions issued by the Federal Regulatory Commission and several state public utility commissions. These commissions include Connecticut, Texas, and Illinois.[1]

Q. PLEASE DESCRIBE THE FERC ORDER.

A. In its Kern River decision, the FERC stated:

> 229. There is a second type of timing [difference] that can have the opposite effect. It is possible that some accounting entries will decrease expenses or increase income for IRS purposes faster than would be the case for accounting purposes. In this case the cash flow from the tax allowance embedded in the regulated entity's rates is less than the income tax payments that are generated by the higher income. When the regulated entity pays for an expense earlier than would be under the Commission's regulatory accounting system, it is in essence committing more funds to the business. The difference is therefore capitalized and added to the rate base. The difference in the timing that results is capitalized and added to the rate base to allow a somewhat higher return on the additional funds that have been committed to the enterprise. As the accounting entries for these expenses are entered (usually allowance for funds used during construction), the difference in timing is reversed, the short term addition to the rate base decreases, and return drops. This timing difference is reflected as an ADIT debit, or regulatory asset, in Account No. 190.
>
> 230. In the instant case the NOL was properly included in Account No. 190. The large depreciation deduction for the "bonus" depreciation was properly reflected as a credit in Account No. 282 and served to reduce rate base to reflect the difference in timing previously described. However, the impact of this deduction was so great that it exceeded the taxable cash that would have been generated under the straight line regulatory method. Thus, Kern River was not able to use the full extent of the deduction in the first year it was available. However, as discussed, the full accelerated depreciation amount is included in the credit ADIT in Account No. 282. Without a corresponding debit in Account No. 190, Kern River's rate base would be reduced even though it did not achieve the tax savings, and

[1] *Kern River Gas Transmission Company*, FERC Docket No. RP04-274-000 (October 19, 2006); *Yankee Gas Services Company*, Conn. Docket No. 10-12-02REO 1, 2011 Conn. PUC Lexis 189 (September 28, *2011); Gulf States Utilities Co.*, Docket No. 8702, 17 Tex. P.u.c. Bull., 703 (P.U.c.Texas May 2, *1991); GUD No. 10170*, Statement of Intent Filed by Atmos Energy Corp., to Increase Gas Utility Rates Within the Unincorporated Areas Served by the Atmos Energy Corp., Mid-Tex Division, Final Order (Dec. 4, 2012) Available at http://www.rrc.state.tx.us/meetings/gspfd/10170-FinalOrder; *Commonwealth Edison Co.*, Docket No. 94-0065, 158 PUR4th 458 (Ill. *CC*, January 9, 1995)

> additional cash flow, that a credit entry in Account No. 282 is intended to offset. Therefore the NOL is carried forward as a regulatory asset in future years and is reduced as the tax savings actually accrue to Kern River.[2]

Q. PLEASE DESCRIBE THE CONNECTICUT ORDER.

A. The Connecticut commission recognized that NOLC's are properly reflected as an increase to rate base. The Commission stated in its Yankee Gas Services decision:

> In the instant proceeding, the Authority finds that the NOL generated during rate year 1 ending June 30, 2012 (RY1) diminished the cash flow available to Yankee as a result of the tax effect of the timing differences between straight line book depreciation and accelerated tax depreciation deductions.[3]

Q. PLEASE DESCRIBE THE TEXAS ORDERS.

A. Both the Texas PUC and the Railroad Commission have provided clear instructions on the inclusion of NOLC ADIT assets. The PUC ruled the following:

> Deferred accumulated federal income taxes are properly included as a credit to GSU's rate base because deferred federal income taxes represent cost free capital to the Company. However, this cost free capital is appropriately reduced to the extent that GSU has NOL carry forwards, which the utility is currently unable to use. Just as deferred income taxes represent future taxes which the utility has not yet been required to pay, NOLs represent deductions to the utility's tax liability which the Company has not yet realized. To the extent that a utility has unutilized NOL carry forwards, its tax liability will be reduced in the future. Therefore, if the Commission is going to include deferred income taxes as a reduction to rate base, which it should, the Commission should likewise include known reductions to those deferred taxes. Consequently, NOLs should be included as an offset in the calculation of the deferred income tax balance included in rate base.[4]

[2] *Kern River Gas Transmission Company*, FERC Docket No. RP04-274-000 (October 19, 2006)

The Texas Railroad Commission ruled likewise:

> The Examiners find that the company has established that its calculation of the ADIT asset related to NOLs was just and reasonable…The company's approach matches the ADIT liabilities to the ADIT NOL asset created by those deductions.[5]

Q. PLEASE DESCRIBE THE ILLINOIS ORDER.

A. The Illinois Commerce Commission ruled as follows:

> We believe, in this instance, Edison's rate base should include a deferred tax asset offsetting the deduction for deferred taxes, so that deferred tax accounting items will be treated consistently. If we were to make this rate base adjustment, the Company well might forfeit its federal deferred income tax benefits. This would be inequitable.[6]

Q. PLEASE SUMMARIZE THESE DECISIONS.

A. All of these commissions ruled that the NOLC ADIT asset should be included as an adjustment to rate base. Each commission recognized that failure to do would understate rate base and ignore the true ADIT related cash flow realized by the petitioners.

Q. HAS MR. OSTRANDER OFFERED ANY PRECEDENTIAL SUPPORT FOR HIS PROPOSED ADJUSTMENT?

A. He cited two regulatory proceedings in support of his position. The first was a Kentucky case filed by Big Rivers Electric Corporation ("BREC") and the second was a West Virginia case filed by Mountaineer Gas Company ("MGC").[7]

---

[3] *Yankee Gas Services Company,* Conn. Docket No. 1 0-12-02REO 1, 2011 Conn. PUC Lexis 189 (September 28, *2011)*

[4] *Gulf States Utilities Co.,* Docket No. 8702, 17 Tex. P.u.c. Bull., 703 (Tex. PUC May 2, 1991)

[5] *GUD No. 10170,* Statement of Intent Filed by Atmos Energy Corp., to Increase Gas Utility Rates Within the Unincorporated Areas Served by the Atmos Energy Corp., Mid-Tex Division, Final Order (Dec. 4, 2012) Available at http://www.rrc.state.tx.us/meetings/gspfd/10170-FinalOrder

[6] *Commonwealth Edison Co.,* Docket No. 94-0065, 158 PUR4th 458 (Ill. *CC,* January 9, 1995)

[7] *In the Matter of Application of Big Rivers Electric Corporation for a General Adjustment in Rates,*

Q. DOES THE BREC CASE OFFER AN OPINION AS TO WHETHER SOUND RATEMAKING PRINCIPLES WOULD RESULT IN THE EXCLUSION OF A NOLC ADIT ASSET?

A. No. As I will explain, the BREC case is not comparable to this proceeding and BREC in its original filing sought no recovery of tax expense, nor did it adjust rate base for any ADIT assets or liabilities.

Q. WHY IS THE BREC CASE NOT COMPARABLE TO THIS PROCEEDING?

A. BREC is a cooperative and as such its tax obligations are substantially different than the Company's. BREC does not pay tax on earnings from its members (rate payers). Its tax liability is based solely on earnings from non-members.

Q. MR. OSTRANDER OFFERS AS SUPPORT FOR HIS POSITION THAT BREC DID NOT SEEK RECOVERY OF ITS TAX EXPENSE OR ITS ADIT ASSETS AND LIABLITIES. IS THIS RELEVANT?

A. No. As a cooperative BREC has no tax obligations for its earnings from members. It is quite appropriate for it to not seek recovery of any tax expense or ADIT items given that it has no tax liability on earnings realized from members. Quite simply, there is nothing to recover.

However, to draw a parallel between BREC and this proceeding is misguided at best. The Company is taxed in a completely different manner and as such what should or should not be included in rate base is understandably different than BREC.

Q. IS THE MGC DECISION CONSISTENT WITH OTHER COMMISSION ORDERS?

A. No. West Virginia is alone in its position despite historical precedent at numerous other commissions to the contrary.

Q. SHOULD THIS COMMISSION ADOPT THE WEST VIRGINIA POISITION?

A. No. There is substantial precedent supporting the Company's proposed treatment of the NOLC ADIT asset. West Virginia is alone and "on an island" with respect to its ruling on this matter. The matter is likely not settled as MGC and West Virginia may litigate the matter further. It would be ill advised for this commission to adopt a position that is new, untested and contrary to numerous other established rulings.

VI. NORMALIZATION REQUIREMENTS AND NOLCs

Q. WHAT IS MR. OSTRANDER'S PRIMARY OBJECTION TO THE INCLUSION OF NOLC ADIT IN RATE BASE?

A. In his direct testimony, Mr. Ostrander does not articulate a true objection to the inclusion of the NOLC ADIT asset in rate base. He states on Page 48, Line 15 of his direct testimony:

> "This amount should be removed from rate base and will not cause any tax normalization violations."

On page 49, Line 9, he continues:

> "I am most concerned with removing the NOLC created by tax bonus depreciation that is causing an income tax loss."

Despite these comments, he never states within his direct testimony why rate base would be better stated with the removal of the NOLC ADIT asset. Finally, at last, in response to Question 10 by the Kentucky PSC Staff, Mr. Ostrander provides a hint to his thoughts. It reads:

> "Mr. Ostrander believes an adjustment is appropriate to remove the accumulated deferred tax impact of the Net Operating Loss Carry-forward from rate base because its inclusion is not a reasonable reading or interpretation of the tax code/Treasury Regulations."

Q. WHAT ARE YOUR THOUGHTS ON MR. OSTRANDER'S PRIMARY OBJECTION TO THE INCLUSION OF NOLC ADIT IN RATE BASE?

A. Mr. Ostrander fails to argue that the NOLC ADIT asset should be excluded based on ratemaking principles. Instead he is arguing that its inclusion is not mandated by the IRC and it should therefore be excluded. This rationale is strange at best. First, the IRC does not dictate what should or should not be included in rate base. The IRC offers no opinion on what is sound ratemaking policy. The decision to include or not include an item in rate base rests solely with the governing regulatory commission. The IRC controls only how a taxpayer is taxed depending on a myriad of circumstances and events.

Mr. Ostrander's position of not including the NOLC ADIT asset because it's "not a reasonable reading or interpretation" of the IRC seems to rest on his belief that the Company would not be subjected to a normalization violation upon its exclusion. Quite simply, he is absolutely incorrect in his opinion that the

Company would not be subjected to a normalization violation if the Commission were to disallow the inclusion of the NOLC ADIT asset. As I will explain, his interpretation of the IRC and regulations is incorrect, and his suggestion of seeking a private letter ruling is an unnecessary exercise given the certainty of the response the Company would receive. If the Commission were to agree to Mr. Ostrander's proposals, the Company would be subjected to punitive rules which would cause the loss of tax benefits granted to it by Congress.

Q. WHAT IS MEANT BY TAX NORMALIZATION IN THE RATEMAKING CONTEXT?

A. There are a myriad of differences between the rules governing the recognition of income and expense for tax purposes versus the recognition of those same items for financial statement purposes. These differences result in both the acceleration and deferral of income tax payments when compared to the income tax expense recorded on a company's financial statements. However, in the context of a utility, the difference between tax expense per the financial statements and the tax paid to the taxing authorities generally results in a deferral of tax. Said differently, current taxes paid to the government are less than the tax expense on the books and records. To use the previous loan analogy, the government has loaned money to the utility by the enactment of favorable tax provisions.

A normalization method of accounting for taxes in its simplest terms strives to keep this incremental cash received from the interest-free loan at the utility level where Congress intended. Tax expense in its cost of service and rate filings are normalized and not artificially lowered for the cash tax savings. In

return, a reserve is recorded against rate base in the amount of the accumulated tax deferred. Such an approach is mutually beneficial both for rate payers and the utility. Rate payers are not paying a return on rate base financed with the cost-free loan that the utility receives from the government.

Q. WHAT IS FULL NORMALIZATION OF TAXES?

A. Full normalization of taxes refers to treating all tax differences as normalized thereby reducing the requested rate base for all taxes deferred. In other words, full normalization reduces rate base by the loan advanced to the company for all differences between taxes paid versus the tax expense realized in cost of service.

Q. DOES THE COMPANY'S FILING IN THIS PROCEEDING REFLECT A FULL NORMALIZATION APPROACH?

A. Yes. The Company has filed utilizing a fully normalized approach.

Q. WHY IS A FULLY NORMALIZED APPROACH APPROPRIATE?

A. A fully normalized approach takes into account all tax deferrals and treats all of them as a reduction to rate base. It is the simplest approach yet also the most balanced between the interests of the rate payer and the utility. Essentially all interest-free loans the Company has received from all taxing authorities are accounted for. The Company is able to use those loans to build utility property infrastructure with cost-free financing and rate payers do not pay a return on that investment.

Q. DOES THE INTERNAL REVENUE CODE REQUIRE NORMALIZATION?

A. As I will explain, the IRC and related regulations provide consequences to those utilities and commissions that do not normalize certain tax benefits. These consequences are draconian. So draconian in fact that the mere threat of them has the effect of "requiring" utilities and commissions abide by them. Certainly a commission could choose to violate the normalization provisions. However, a utility or commission that knowingly violated the IRC normalization provisions would arguably be negligent in looking out for the best interests of its rate payers.

Q. WHICH TAX BENEFITS ARE REQUIRED TO BE NORMALIZED UNDER THE IRC?

A. The IRC requires that the deferral of tax associated with tax depreciation be normalized.

Q. WHAT ARE THE TAX DEPRECIATION NORMALIZATION RULES?

A. Accelerated depreciation was enacted by Congress as an investment incentive for businesses. In a regulated environment, Congress was concerned that the tax savings from accelerated depreciation would be flowed through to rate payers thereby negating the incentive it sought to create. To discourage utilities and commissions from flowing the incentive through to rate payers, Congress enacted the depreciation normalization rules. The tax depreciation normalization rules mandate the normalization process I previously described for all items associated with tax depreciation. In other words, deferred accounting must be utilized and the balance of deferred taxes must be adjusted out of rate base.

Q. HOW DOES TAX DEPRECIATION NORMALIZATION WORK?

A. As defined under Treas. Reg. §1.167(l)-1(h), in order to use a normalization method of accounting, the public utility must use the "same method" of depreciation to compute both its tax expense and its depreciation expense for purposes of establishing its cost of service for ratemaking purposes and for reflecting operating results in its regulated books of account. Further, if in computing its allowance for tax depreciation for purpose of filing its tax returns, it uses a method other than that used for establishing its cost of service for ratemaking purposes and for reflecting operating results in its regulated books of account, the utility must make adjustments to an accumulated deferred federal income tax reserve to reflect the deferral of taxes resulting from the use of the different methods of depreciation. *(Treas. Reg. §1.167(l)-1(h)(1)(i)(a) and (b)).* The established reserve must be used in ratemaking proceedings to reduce the utility's rate base upon which the rate of return is applied. A taxpayer DOES NOT use a normalization method if, for ratemaking purposes, the amount of the accumulated deferred federal income tax reserve which is excluded from rate base exceeds the amount in the reserve for deferred taxes for the period used in determining the taxpayer's cost of service. *(Treas. Reg. §1.167(l)-1(h)(6)(i))*

Q. WHAT IS THE IMPACT TO A PUBLIC UTILITY IF IT DOES NOT MAINTAIN A NORMALIZED METHOD OF ACCOUNTING?

A. If a public utility believes its method of accounting is not a normalized method or is compelled by a regulatory body to adopt a method which is not normalized, the utility must notify the Service's District Director within 90 days and file amended returns which recompute its tax liability for any affected taxable years.

Prospectively, the utility would lose the ability to claim accelerated tax depreciation on future tax returns.

Q. DO THE TAX DEPRECIATION NORMALIZATION RULES TAKE INTO ACCOUNT A NOLC?

A. They absolutely do. The normalization rules apply to any portion of the NOLC that is attributable to the accelerated tax depreciation.

Q. HOW DO YOU REACH THIS CONCLUSION?

A. Treasury Regulation §1.167(l)-1(h)(1)(iii) addresses the situation specifically. It provides that if by use of accelerated depreciation, the taxpayer generates a NOLC which would have otherwise not arisen, then the amount and time of tax depreciation deferral shall be taken into account for rate base in an appropriate time and manner as is satisfactory to the District Director.

Q. EFFECTIVELY WHAT DOES THIS MEAN?

A. A taxpayer in computing the amount of ADIT credit by which to reduce rate base must take into account a NOLC ADIT asset. A NOLC ADIT asset, to the extent created by depreciation deductions, represents depreciation deductions that have not yet resulted in a tax deferral. To use the loan analogy, if a NOLC has been created by the accelerated tax depreciation, then a loan HAS NOT yet been extended to the company. To reduce a utility's rate base for the full amount of deferred tax generated by the accelerated depreciation and not take into account the generation of a NOLC would essentially impute a loan that has not occurred and more importantly violate the normalization provisions.

Q. IF A TAXPAYER DOES NOT FACTOR ITS NOLC ADIT INTO THE OFFSET TO RATE BASE, WHAT HAPPENS?

A. The taxpayer would be in violation of this provision and would have a "normalization violation" under the IRC. It would be required to notify the IRS of such a violation and it would be prohibited from using accelerated depreciation. It would be required to file amended returns reversing the use of accelerated depreciation. In short it would have an immediate and negative cash flow impact on the taxpayer. It would be catastrophic from a tax standpoint.

Q. HAS THE COMPANY FACTORED THE NOLC ADIT ASSET INTO ITS DEFERRED TAXES APPLIED TO RATE BASE AND COMPLIED WITH TREASURY REGULATION §1.167(l)-1(h)(1)(iii)?

A. Yes.

Q. IF THE COMMISSION FOLLOWED MR. OSTRANDER'S RECCOMMENDATIONS, WOULD THE COMPANY BE IN VIOLATION OF TREASURY REGULATION §1.167(l)-1(h)(1)(iii)?

A. Yes.

Q. WHAT ARE YOUR THOUGHTS ABOUT MR. OSTRANDER'S RECOMENDATION TO SEEK A PRIVATE LETTER RULING?

A. Seeking a Private Letter Ruling ("PLR") from the IRS is a costly and a timely undertaking. It seems a waste of resources and time to seek a ruling on an issue that is so completely clear. There is no requirement in the Treasury Regulations for a commission or company to seek a ruling in order to include an ADIT NOLC asset in rate base.

Q. REGARDLESS, HAS THE IRS PREVIOUSLY RULED ON THIS ISSUE?

A. Yes, the IRS issued PLR 8818040 on February 9, 1988 that addresses NOLCs. A copy of the ruling is attached as Exhibit PM - 1

Q. PLEASE EXPLAIN THE PLR.

A. A utility in 1985 and 1986 incurred substantial accelerated tax depreciation deductions. Not all of those deductions could be used and as a result the utility reported a NOLC on its tax returns. The utility proposed to reflect the deferred tax from tax depreciation in rate base in 1987, which is the year the NOLC would be used. The PLR held this approach would be consistent with the normalization rules. One factor that was also addressed in the PLR was the difference in tax rates between 1987 and the earlier years. The IRS also ruled which rate should be used to calculate the deferred taxes given the change in tax rate. Regardless of the tax rate issue, the fact remains that the IRS ruled a NOLC ADIT asset should be considered when determining the proper amount of ADIT to apply to rate base.

Q. ARE YOU AWARE OF THE RECENT WEST VIRGINIA COMMISION RULING THAT MR. OSTRANDER CITES AS SUPPORT THAT NORMALIZATION VIOLATION WOULD NOT OCCUR IF THE NOLC ADIT ASSET IS REMOVED FROM RATE BASE?

A. Yes, I am.

Q. WHAT ARE YOUR THOUGHTS ON THAT RULING?

A. The West Virginia commission's recent ruling stands alone in its position despite historical precedent at numerous other commissions to the contrary. It was incorrect in determining that a normalization violation will not occur by its

actions. In fact, the commission opined on a subject over which it has no jurisdiction. A commission cannot rule whether a normalization violation has or has not occurred. That determination rests solely with the IRS. A commission can only implement rates. If in setting rates, a commission violates the normalization provisions, the IRS would be the authority to rule as such and apply the consequences of said violation. The West Virginia commission most certainly set rates that are in violation of the normalization provisions and overstepped its bounds in ruling that no violation has occurred.

Q. SHOULD THIS COMMISSION LOOK TO THE WEST VIRGINIA COMMISSION'S RULING FOR GUIDANCE ON THIS ISSUE?

A, No. The West Virginia Commission erred in its finding. I have cited numerous other rulings at a variety of commissions that contradict the lone ruling in West Virginia. This commission should look to those jurisdictions for support on this issue.

VII. KNOWN AND MEASURABLE

Q. DO YOU AGREE WITH MR. OSTRANDER THAT THE NOLC ADIT ASSET IS NOT KNOWN AND MEASURABLE AND SHOULD THEREFORE BE EXCLUDED FROM RATE BASE?

A. No. Mr. Ostrander is not only incorrect but as I will explain he was inconsistent in applying his known and measurable objection.

Q. WHY DOES MR. OSTRANDER ARGUE THAT THE NOLC ADIT ASSET IS NOT KNOWN AND MEASURABLE?

A. His argument is based quite simply on the premise that an NOLC is known and measurable only upon the filing of a tax return.

Q. IS THE COMPANY'S NOLC ADIT ASSET INCLUDED IN THIS FILING KNOWN AND MEASURABLE?

A. Yes.

Q. PLEASE EXPLAIN WHY IT IS KNOWN AND MEASURABLE.

A. This case was filed using actual per-books NOLC ADIT balances as of March 31, 2013 and a forward looking period to November 30, 2014. The events that occurred prior to March 31, 2013 have transpired. The tax impact of those periods is known and measurable. It is standard practice for large companies to continually measure and evaluate its tax position and the consequences of its operations. They must evaluate what tax liability to report on estimated tax filings as well as quarterly financial statements. The mere fact that a tax return has not yet been filed does not mean the Company is unknowledgeable about what will ultimately be reported on the return for a given period. With respect to future periods, companies routinely forecast and estimate tax filings. They do so to anticipate cash needs and financial tax expense. It is no different than the forecasting of other items within the filing.

Q. WHY IS THE FILING OF A TAX RETURN NOT A REASONABLE BASIS FOR DEFINING KNOWN AND MEASURABLE?

A. Filing a tax return is an administrative act. The placing of numbers on a form does not dictate the tax results of a company's operations. To argue so would imply that a company's tax results are or can be influenced by a mere form. That is

simply not the case. A company's tax obligation arises when it operates and conducts business.

In addition, a tax return for a company can be prepared and filed up to 9 months after its year end. If a commission were to look to the tax return as the sole indicator of known and measurable, a delay of up to 19 months could occur between the events included in a filing and the tax consequences being considered known and measurable. Such a result is nonsensical and would result in a substantial mismatch of costs in the ratemaking process.

Q. HAS MR OSTRANDER BEEN CONSISTENT WITH HIS KNOWN AND MEASURABLE ARGUMENT?

A. No.

Q. IN WHAT WAY HAS MR. OSTRANDER BEEN INCONSISTENT?

A. Mr. Ostrander has argued that the ADIT NOLC asset should be excluded from rate base because a tax return has not been filed and it is therefore not known and measurable. However, the Company has numerous ADIT liabilities that are treated as a reduction to rate base for which he has not raised a similar argument. These are items that are also forecasted by the Company much like the NOLC. These items are also reportable on a tax return in the future, much like the NOLC. Despite this, Mr. Ostrander has not proposed any adjustment.

I find it strikingly inconsistent that Mr. Ostrander argues a tax filing is necessary for the NOLC ADIT asset to be known and measurable but is perfectly fine with an ADIT liability that is not yet supported by a filed tax return. He appears to advocate a standard whereby increases to rate base for ADIT assets

must be supported by a tax return while decreases to rate base need not be supported by a filed tax return.

VIII. CONCLUSION

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF RATE APPLICATION OF ATMOS ENERGY CORPORATION	)))	Case No. 2013-00148

CERTIFICATE AND AFFIDAVIT

The Affiant, Pace McDonald, being duly sworn, deposes and states that the prepared testimony attached hereto and made a part hereof, constitutes the prepared rebuttal testimony of this affiant in Case No. 2013-00148, in the Matter of the Rate Application of Atmos Energy Corporation, and that if asked the questions propounded therein, this affiant would make the answers set forth in the attached prepared rebuttal testimony.

Pace McDonald

STATE OF Texas

COUNTY OF Dallas

SUBSCRIBED AND SWORN to before me by Pace McDonald on this the 18th day of November, 2013.

PAMELA L. PERRY
My Commission Expires
October 29, 2016

Pamela L. Perry
Notary Public

My Commission Expires: 10-29-16

Private Letter Rulings

Private Letter Ruling 8818040, 2/09/1988, IRC Sec(s). 167

UIL No. 0168.08-02

Headnote:

***Reference(s)*: Code Sec. 167;**

Private Letter Ruling 8818040

Code Sec. 167 DEPRECIATION -- special situations -- public utility property -- carryover of NOL .

Taxpayer (T) is regulated public electric utility. T is required to use normalization method of accounting as condition to its use of accelerated depreciation methods. T wishes to carryover NOL from 1986 to 1987. RULED: To extent use of ACRS depreciation in 1986 and prior years in determining depreciation expense for tax purposes contributed to NOL carryover from 1986 to 1987, T's use of 1987 tax rate in computing deferred tax expense on its regulated books of account will be consistant with normalization requirements.

Full Text:

Feb. 9, 1988

This is in response to your request for a letter ruling dated November 23, 1987, submitted on your behalf

by your authorized representative. You have asked us to rule whether, to the extent that the use of the Accelerated Cost Recovery System (ACRS) in 1986 and prior years in determining the taxpayer's depreciation expense for Federal income tax purposes contributed to a net operating loss (NOL) carryover from 1985 and 1986 to 1987, the taxpayer's use of the Federal statutory income tax rate in effect in 1987 for purposes of computing the deferred tax expense in its regulated books of account for the year 1987 will be consistent with the normalization requirements under sections 167 and 168 of the Internal Revenue Code and the Income Tax Regulations promulgated thereunder.

The taxpayer is incorporated under the laws of the State of . . . , has its principal executive offices at . . . , and files its returns with the Internal Revenue Service in . . . . The taxpayer files its returns using a calendar year. The Internal Revenue Service (IRS) district office in . . . has examination jurisdiction over the taxpayer's return.

The taxpayer is a regulated public utility transmitting and distributing electric power. It has been represented under penalty of perjury that the Commission has been apprised of the taxpayer's ruling request and has no objection to the issuance of a ruling on the request.

As a public utility, the taxpayer is required to use the normalization method of accounting as a condition to its use of accelerated depreciation methods, including ACRS, for Federal income tax purposes. Accordingly, the taxpayer records deferred tax expense for financial statement and regulatory purposes pursuant to the provisions of sections 167 and 168 of the Code and the regulations thereunder. Hereinafter, the accelerated depreciation that the taxpayer is required to normalize is referred to as ACRS.

The amount of Federal income tax expense that the taxpayer recorded for financial statement purposes for 1986 and prior years was greater than the Federal income taxes actually paid. The additional recorded Federal income taxes (deferred taxes) resulted, in part, from a significant amount of property placed in service in 1985, which increased the depreciation deduction for Federal income tax purposes. However, the taxpayer did not realize the entire tax benefit from the ACRS depreciation claimed in 1985 and 1986 because the depreciation resulted in a NOL carryover to 1987. Therefore, in order to reflect the tax benefit of the NOL carryover to 1987, the taxpayer reduced its deferred Federal income tax expense and liability for 1985 and 1986 for financial reporting purposes. The net effect of this accounting in 1985 and 1986 was to record no deferred taxes applicable to the amount of ACRS depreciation that produced no current tax savings but rather caused or increased taxpayer's NOL carryover to 1987. The taxpayer only recorded deferred taxes applicable to ACRS when and to the extent that the use of ACRS produced an actual tax deferral.

The taxpayer will have taxable income in 1987 in excess of the NOL carryover from 1986. Consequently, the ACRS depreciation that was claimed in 1985 and 1986, but did not then produce a tax benefit, will produce a benefit in 1987 when the NOL is utilized. Accordingly, for 1987 the taxpayer proposes to record the deferred Federal income tax expense resulting from the use of the NOL carryover from 1986 at the rate of 39.95%, the effective income tax rate for 1987. This rate is lower than the 46 percent rate in effect

during 1986 and the prior years when the ACRS depreciation was originally deducted on the taxpayer's Federal income tax return.

Section 168(f)(2) of the Code generally requires the use of the normalization method of accounting with respect to regulated public utility property in order for the public utility to be allowed to use ACRS depreciation for Federal income tax purposes.

Section 168(i)(9)(A) of the Code sets forth the normalization accounting requirements. This section provides that the taxpayer must, in computing its tax expense for purposes of establishing its cost of service for rate making purposes and reflecting operating results in its regulated books of account, use a method of depreciation with respect to such property that is the same as, and a depreciation period for such property that is no shorter than, the method and period used to compute its depreciation expense for such purposes. In addition, if the amount allowable as a deduction under this section with respect to such property differs from the amount that would be allowable as a deduction under section 167 (determined without regard to section 167(1)) using the method (including the period, first and last year convention, and salvage value) used to compute regulated tax expense under clause (i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

Section 1.167(1)-1(h)(1)(i) of the regulations provides that a taxpayer uses a normalization method of regulated accounting if the taxpayer makes adjustments to a reserve to reflect the total amount of the deferral of Federal income tax liability resulting from the use with respect to all of its public utility property of such different methods of depreciation.

Section 1.167(1)-1(h)(1)(iii) of the regulations provides that, except as provided in this subparagraph, the amount of Federal income tax liability deferred as a result of the use of different methods of depreciation under subdivision (i) of this subparagraph is the excess (computed without regard to credits) of the amount the tax liability would have been had a subsection (1) method been used over the amount of the actual tax liability. Such amount shall be taken into account for the taxable year in which such different methods of depreciation are used. If, however, in respect of any taxable year the use of a method of depreciation other than a section (1) method for purposes of determining the taxpayer's reasonable allowance under section 167(a) results in a net operating loss carryover (as determined under section 172) to a year succeeding such taxable year which would not have arisen (or an increase in such carryover which would not have arisen) had the taxpayer determined his reasonable allowance under section 167(a) using a subsection (1) method, then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director.

Under the regulations, the amount of deferred taxes is computed using a "with and without" methodology. (That is, deferred taxes equal the excess of taxes due without ACRS over the taxes due with ACRS). Where taxes computed with ACRS produce a NOL carryover, the amount and time of the deferral is left to the discretion of the Internal Revenue Service.

The taxpayer maintains that where the computation utilizing ACRS results in a NOL, the deferral is appropriately made at the time the taxpayer realizes an actual tax benefit from the use of ACRS. The taxpayer will realize the benefit of the NOL attributable to the accelerated depreciation in 1987. Therefore, the taxpayer should record the deferred taxes in 1987. We conclude that this approach is consistent with the normalization requirements under sections 167 and 168 of the Code.

With respect to the amount of the deferral, the Federal statutory income tax rates in effect in 1987 for calendar year taxpayers, pursuant to the Tax Reform Act of 1986, can reasonably be combined to result in an effective rate of 39.95 percent. See section 3 of Rev. Proc. 88-12, 1988-8 I.R.B. . . . . This is lower than the 46 percent rate in effect when the NOL was incurred. Because the deferred taxes are being recorded in 1987, it is appropriate to utilize the effective tax rate for that year. We note that this approach is consistent with generally accepted accounting principles as set forth in APB Opinion No. 11, ACCOUNTING FOR INCOME TAXES. Regarding NOL's, the APB Opinion provides that if loss carryforwards are realized in periods subsequent to the loss period, the amounts eliminated from the deferred tax credit account should be reinstated at the then current tax rates. We conclude that the taxpayer's methodology satisfies the normalization requirements of sections 167 and 168 of the Code.

Accordingly, to the extent that the use of ACRS depreciation in 1986 and prior years in determining depreciation expense for Federal income tax purposes contributed to a NOL carryover from 1986 to 1987, the taxpayer's use of the effective tax rate for 1987 (39.95 percent for calendar year taxpayers) in computing the deferred Federal income tax expense on its regulated books of account for the year 1987 will be consistent with the normalization requirements of sections 167 and 168 of the Code and the regulations thereunder.

This ruling is directed only to the taxpayer who requested it.  Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this private letter ruling is being sent to your authorized representative in accordance with the power of attorney on file with this office.

A copy of this ruling letter should be filed with the income tax return for the taxable year or years in which the transaction covered by this ruling is consummated.

EXHIBIT

F

REQUEST:

(a) With reference to Atmos' responses to the Consumer Advocate's First Discovery Requests No. 37 and MFR No. 6, please state whether the attached Ruling Request for Atmos Energy Corporation dated January 9, 2015 ("Ruling Request"), letter from the Kentucky Attorney General to the Kentucky Public Service Commission dated December 12, 2014 ("KY AG Letter"), letter from Atmos to the Kentucky Public Service Commission dated December 12, 2014 ("Atmos Reply Letter"), Supplemental and Corrected Direct Testimony of Bion C. Ostrander, public version, dated November 18, 2013 ("Ostrander Direct Testimony"), and the Rebuttal Testimony of Pace McDonald dated November 18, 2013 ("McDonald Rebuttal Testimony") are complete (including all attachments and exhibits thereto) copies.

(b) To the extent that any of the foregoing documents is not complete (including all attachments and exhibits thereto), please provide a complete copy of each such document.

(c) Also, please state whether each position taken by Atmos in the Ruling Request, Atmos Reply Letter, and McDonald Rebuttal Testimony continues to be the position of Atmos on each issue and matter described in each of those documents.

(d) To the extent a position taken by Atmos in any of the Ruling Request, Atmos Reply Letter, and McDonald Rebuttal Testimony does not continue to be the position of Atmos on each issue and matter described in each of those documents, please so state with respect to each such changed position and provide the reason and rationale for each such change.

RESPONSE:

a) The attachments are complete.

b) Not applicable. Please see the response to subpart (a).

c) Yes, the Company continues to support without modification the positions in the ruling request, reply letter and testimony.

d) Not applicable. Please see the response to subpart (c).

Respondent: Pace McDonald / Jennifer Story