

**IN THE TENNESSEE PUBLIC UTILITY COMMISSION
AT NASHVILLE, TENNESSEE**

IN RE:

**PETITION OF ATMOS ENERGY
CORPORATION FOR APPROVAL OF
2017 ANNUAL RECONCILIATION
FILING**

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DOCKET NO. 17-00091

CONSUMER ADVOCATE'S PRE-HEARING REPLY BRIEF

The Consumer Protection and Advocate Division of the Office of the Attorney General (Consumer Advocate) respectfully submits this Pre-Hearing Reply Brief in response to the Pre-Hearing Brief of Atmos Energy Concerning Tax Normalization (Pre-Hearing Brief) in Tennessee Public Utility Commission (Commission or TPUC) Docket No. 17-00091 (this Docket or Reconciliation Docket), Petition of Atmos Energy Corporation for Approval of 2017 Annual Reconciliation Filing.

I. SUMMARY

On March 12, 2018, Atmos Energy Corporation (Atmos or Company) unexpectedly filed Atmos' Pre-Hearing Brief. The Consumer Advocate believes the filing of the Pre-Hearing Brief was not proper in view of the Commission's order on February 26, 2018, and has filed a contemporaneous Motion in Limine to exclude from consideration the issue of an alleged tax normalization violation.

Nevertheless, in response to Atmos' apparent contention that a normalization violation would result from using income tax expense from fiscal year end September 30, 2016, to reconcile the period covered by this Reconciliation Docket ending on May 31, 2017, the Consumer Advocate contends that Atmos has not demonstrated that a tax normalization violation

would result from using per-books actual results in this Reconciliation Docket, or that this Reconciliation Docket is the correct docket to determine compliance with the tax normalization rules. In addition, Atmos does not show that its proposed income tax expense methodology would true-up its budget filing to actual results, or that its proposal would not result in a normalization violation. Thus, the tax normalization issues raised in Atmos' Pre-Hearing Brief should be rejected in this Docket.

Further, notwithstanding Atmos' characterization of the Consumer Advocate's position as resulting in a tax normalization violation, Atmos bears responsibility for any such problem and has not presented a viable proposal to solve what Atmos believes to be an issue in this Reconciliation Docket, and hence, the annual rate review mechanism (ARM) process.

II. BACKGROUND

The facts underlying the issue raised by Atmos' Pre-Hearing Brief originated from Atmos' opting into an ARM in Docket No. 14-00146, which was resolved through a Stipulation and Settlement Agreement (14-00146 Settlement Agreement) that was approved by the Commission and incorporated into its Order in its entirety.¹

Since the approval of the 14-00146 Settlement Agreement, there have been six filings under Atmos' ARM. Two of those filings permitted Atmos to put its budget for the upcoming year into rates,² and one reconciled the original amounts put into rates in TPUC Docket No. 14-00146.³ In the initial reconciliation docket, Atmos and the Consumer Advocate entered into a Settlement Agreement (16-00105 Settlement Agreement) that reflected certain adjustments to the ARM. The Commission's Order in that Docket confirmed that the methodologies used reflected

¹ Order Approving Settlement, as filed in TPUC Docket No. 14-00146 on November 4, 2015.

² TPUC Docket Nos. 16-00013 and 17-00012.

³ TPUC Docket No. 16-00105.

the methodologies in the 14-00146 Settlement Agreement.⁴ In the current reconciliation docket, Atmos again seeks to reconcile its actual results to its budget filing.⁵

In seeking to reconcile its actual results to the budget, Atmos' current reconciliation filing originally sought to change the income tax expense methodology that had been approved in Docket No. 16-00105 to reflect a calculation that essentially multiplied Atmos' required revenue amount by Atmos' statutory federal tax rate.⁶ The potential rate impact on consumers from this change is significant – over \$3 million.⁷ Atmos' original rationale for changing that methodology was so that Atmos could align its income tax expense year as used in projecting the budget with the actual expense year in the reconciliation year, but that reason appears to have given way to an apparent discovery of a tax normalization violation by Atmos under the Internal Revenue Code.⁸

After disagreement arose about whether a tax normalization violation exists and Atmos' original proposed methodology to fix it, and rebuttal and supplemental testimony were filed, Atmos filed a Motion to Resubmit Reconciliation and Change Dates (Motion) in this Docket No. 17-00091, and a Petition of Atmos Energy Corporation (Budget Date Petition) in TPUC Docket

⁴ Order Approving Settlement Agreement, as filed in TPUC Docket No. 16-00105 on February 2, 2017.

⁵ The budget filing to which the current Docket is being reconciled is TPUC Docket No. 16-00013.

⁶ Pre-Filed Testimony of Gregory K. Waller (Waller Direct Testimony), filed in TPUC Docket No. 17-00091, Page 18, line 18, through Page 19, line 10 (referencing the Pre-Filed Testimony of Jennifer K. Story (Story Direct Testimony), filed in TPUC Docket No. 17-0091).

⁷ Atmos' original request in this Reconciliation Docket was a rate **increase** adjustment of \$850,177 using its new proposed income tax expense calculation, while the amount that Atmos would have requested using the income tax expense methodology in the prior reconciliation docket would have been a **refund** adjustment of \$2,525,475. Contrast Schedule 1 of Exhibit GWK-1 with Schedule 1 of GWK-2, as both are attached to the Waller Direct Testimony. Further, the Consumer Advocate recently confirmed, in a response filed March 7, 2018, to a data request from the Commission, that a **refund** adjustment of \$3,477,452 would reflect a full revenue requirement calculation that included a true-up to actual income taxes and adjustments for per-books interest expense and cash working capital.

⁸ In view of Atmos' rebuttal testimony about the seriousness of a potential normalization violation and the discovery of the violation during the preparation of this current reconciliation filing, it is perhaps significant that Atmos would totally omit the potential normalization violation from its original petition, the Waller Direct Testimony, and the Story Direct Testimony. See Pre-Filed Rebuttal Testimony of Jennifer K. Story (Story Rebuttal Testimony), filed in TPUC Docket No. 17-00091, Page 11, lines 8-9 ("The Company identified the [normalization] issue during the preparation of the current filing"), and Page 12, line 19, through Page 13, line 3.

No. 18-00003, Atmos Energy Corporation Request to Change Certain ARM Dates. The Motion and Budget Date Petition essentially requested approval to change Atmos' ARM budget and reconciliation years to be the same as its corporate fiscal year.⁹ The normalization issue that is the subject of Atmos' Pre-Hearing Brief and this Pre-Hearing Reply Brief was a part of the briefs that were filed by Atmos and the Consumer Advocate after the January 19, 2018 hearing on the Motion and Budget Date Petition. The Motion and Budget Date Petition were denied by the Commission on February 26, 2018, with the evidentiary hearing in this Docket set to be held at the next Commission conference.¹⁰

As the apparent basis for the denials and reset of the evidentiary hearing, the Commission found "that since no rates will change at the conclusion of this docket, it is not the appropriate docket [that is, Docket No. 17-00091] to resolve any potential tax normalization violations. Rather, any amount of revenue sufficiency or deficiency found in this docket will be carried forward for inclusion in the next annual rate review budget filing wherein rates will be changed."¹¹ After that exclusion of the normalization issue in this Docket, the Consumer Advocate began preparation for the hearing on the merits at the next Commission conference.

Then, as noted above, on March 12, 2018, Atmos unexpectedly filed Atmos' Pre-Hearing Brief. The sole subject matter of Atmos' Pre-Hearing Brief concerned the tax normalization issue. The Hearing Officer cancelled the hearing set for March 19, offered the Consumer Advocate the opportunity to file a reply brief, and reset the hearing on the merits for

⁹ Atmos provided the underlying reason for Motion and Budget Date Petition as being a solution to the income tax issue or, as otherwise generally known in the context of Atmos' date change request, the tax normalization issue. Motion, Page 2, in the first sentence, and Budget Date Petition, Page 2, Paragraphs 5 and 6.

¹⁰ Transcript of Commission Conference held February 26, 2018 (Conference Transcript), Page 4, lines 3-10. The next Commission conference would have been March 19, 2018.

¹¹ Conference Transcript, Page 4, lines 11-18.

April 9, 2018. This Pre-Hearing Reply Brief addresses the issues raised in Atmos' Pre-Hearing Brief.

III. ATMOS HAS NOT DEMONSTRATED THAT A TAX NORMALIZATION VIOLATION WOULD RESULT FROM USING PER-BOOKS ACTUAL RESULTS IN THIS RECONCILIATION DOCKET, OR THAT THIS RECONCILIATION DOCKET IS THE CORRECT DOCKET TO DETERMINE COMPLIANCE WITH THE TAX NORMALIZATION RULES.

Atmos has not provided, in its Pre-Hearing Brief, hearing testimony, or pre-filed rebuttal testimony, quantitative support for its assertion that the treatment of income tax expense in the current Reconciliation Docket "is clearly a normalization violation."¹² While this lack of support in testimony has been well established,¹³ Atmos' Pre-Hearing Brief merely reiterates certain IRS Treasury Regulations and includes a few selected IRS private letter rulings and documents from the Docket that add nothing to show quantitatively that a normalization violation would occur by using booked actual results in this Reconciliation Docket. In addition, as a part of its efforts to criticize what it characterizes as the Consumer Advocate's position,¹⁴ Atmos suggests a number of hypotheticals that it claims prove, without any supporting data, that a normalization violation would occur if actual results from September 30, 2016 were used in this Reconciliation Docket. Those hypotheticals likewise do not support a finding of a tax normalization violation when considered in the context of the ARM process.

In view of that lack of support, and as an almost preliminary matter, the Consumer Advocate notes that the Company's view that the Consumer Advocate's income tax expense

¹² Story Rebuttal Testimony, Page 10, line 16 through Page 11, line 4.

¹³ Atmos offered no data in rebuttal testimony or hearing testimony that would demonstrate its claimed violation of the tax normalization rules. In fact, in response to a question from Commissioner Jordan at the hearing on the Motion, Story admitted she did not know – and stopped her analysis before she knew – the amounts in Atmos' filings that would have been used to determine whether a tax normalization violation exists. Transcript of Commission Conference held January 16, 2018, recording the hearing on the Motion held in Docket No. 17-00091 (Hearing Transcript), Page 114, line 25, through Page 115, line 11.

¹⁴ It should be emphasized that what Atmos characterizes as the Consumer Advocate's position is the same position that was agreed to by the Parties and approved by the Commission in Docket No. 14-00146 and then confirmed and approved by Atmos, the Consumer Advocate, and the Commission in Docket No. 16-00105.

calculation will somehow violate the tax normalization rules is a bit of a red herring. The only entity that can speak definitively to whether a tax normalization violation has occurred is the IRS,¹⁵ with the principal means being through a private letter ruling. Atmos witness Story, however, has rejected seeking a private letter ruling on Atmos' tax normalization problem.¹⁶ With that said, and as further described in this Pre-Hearing Reply Brief, there is no apparent direct authority that addresses the ARM process as it operates in this Reconciliation Docket in connection with the budget filing.

So, if the Company believes that such a violation has occurred¹⁷ and persists in that belief, then the Consumer Advocate respectfully recommends that Atmos be ordered to obtain a private letter ruling in collaboration with the Commission and Consumer Advocate. That collaborative private letter ruling request could definitively resolve this issue.¹⁸ If the IRS deems that the use of per-books actual results in the context of the ARM process is a tax normalization violation after a complete and accurate analysis of the facts and law, the issue would be settled, and the ARM process could continue as intended, with the appropriate adjustments being made. However, unless and until such guidance from the IRS is received, there would not appear to be

¹⁵ Novak Supplemental Testimony, Page 7, lines 5-9.

¹⁶ Story Rebuttal Testimony, Page 14, line 18, through Page 15, line 22.

¹⁷ Atmos' admission that it has not followed as-yet-unidentified IRS Treasury Regulations requiring notice to the IRS of a tax normalization violation calls into question whether Atmos believes its own claim. See Hearing Transcript, Page 110, lines 2-20. Story, in her rebuttal testimony and hearing testimony, says that Atmos had 90 days, from the date Atmos believed that its method of accounting is not a normalized method, to notify the IRS District Director. Hearing Transcript, Page 108, line 23, through Page 109, line 6. Story admits that it has been more than 90 days and that the IRS District Director has not been notified. Hearing Transcript, Page 110, line 25, through Page 111, line 8. Story attempts to use an IRS Revenue Procedure to say that the 90 days would not start until its requirements are met, but finally admits that the 90-day requirement is not in the Revenue Procedure. Hearing Transcript, Page 108, line 23, through Page 111, line 21. Thus, the Revenue Procedure is independent of the 90-day requirement and if Atmos believed it had committed a tax normalization violation, it should have filed the notification with the IRS. Atmos did not file, so there is at least a question about whether Atmos believes there is in fact a tax normalization violation.

¹⁸ Further, this would appear to provide some relief to Atmos under the Revenue Procedure repeatedly mentioned by Atmos as providing its only protection against what Atmos states would be serious effects of a normalization violation actually occurring. See Revenue Procedure 2017-47 (Rev. Proc. 2017-47), Page 10, Section 4.07(3) (for ease of reference, Rev. Proc. 2017-47 is attached to Atmos' Pre-Hearing Brief).

a definitive basis for Atmos' new position that using actual income tax expense recorded on the books would not be the appropriate amount to recognize in this ARM Reconciliation Docket.

With the red herring nature of its argument noted, Atmos, in its Pre-Hearing Brief, initially focuses on the standard set out in IRS Treas. Reg. § 1.167(1)-1(h)(6)(i). That standard provides that:

(i) Notwithstanding the provisions of subparagraph (1) of this paragraph, a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes under section 167(l) which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's tax expense in computing cost of service in such ratemaking.

This Treasury Regulation has been argued by Atmos previously. In rebuttal testimony, Story states that "Treas. Reg. § 1.167(1)-1(h)(6)(i) is very clear that the time period for which income tax expense and accumulated deferred federal income taxes ... included in the Company's rate filings must be the same."¹⁹ In its Pre-Hearing Brief, Atmos summarizes this argument as "[i]n other words, the Normalization Rules do not permit rate base to be reduced by an amount of deferred taxes in excess of the amount that has been reflected (or is projected to be reflected) in cost of service during the period (hereinafter, the "Limitation")."²⁰

In its Pre-Hearing Brief, though, Atmos makes the assertion that "contrary to the Limitation, the Consumer Advocate's position uses an ADIT balance (from May 31, 2017) that is higher than the ADIT balance from the period used to determine tax expense (September 30, 2016)"²¹ and cites two documents from the record.²² However, a review of those documents in

¹⁹ Story Rebuttal Testimony, Page 4, lines 9-11. Note that apparently any time period will do under Story's analysis, as long as they are the same. Hearing Transcript, Page 117, line 9, through Page 118, line 16.

²⁰ Pre-Hearing Brief, Page 3.

²¹ Pre-Hearing Brief, Page 6.

the context of the methodologies used in the Docket shows that Atmos' claim is at best misleading. The reference to those two documents is misleading because in the reconciliation process, as Atmos knows, both the Company and the Consumer Advocate calculate a thirteen-month average of ADIT and not an end of period (May 31, 2017) ADIT amount.²³ In other words, Atmos is not using the methodology that the Parties use in calculating the ADIT amounts. Thus, the comparison of the two ADIT amounts in a determination related to the standards in the Treasury Regulations and Limitation would not be a meaningful comparison. So Atmos' attempt to point to the two specific amounts on two specific dates, without explanation or analysis, does not demonstrate that a tax normalization violation would occur and, further, appears to reinforce the lack of support for Atmos' claim of a normalization violation.

Likewise lacking support is Atmos' additional claim that the statutory consistency requirement of Internal Revenue Code § 168(i)(9)(B) (Consistency Rule) is not met. This Consistency Rule generally precludes the use of inconsistent procedures or adjustments in certain contexts. Not meeting the Consistency Rule could result in a normalization violation. Along these lines, Atmos asserts that the Consistency Rule "precludes the mixing and matching of regulatory conventions and measurement periods where that practice impacts the benefits of accelerated depreciation."²⁴ Again, however, Atmos provides no data that would demonstrate

²² Atmos cites Exhibit GKW-R-1, WP 7-1, and Atmos Energy Resp. to CPAD DR 1-10, Att. 3, Plant Balances 2017 TN True-Up Filing.xlsx (filed October 19, 2017).

²³ In calculating the average investment (rate base) for the 13 months ended May 31, 2017, the Consumer Advocate examines the balance of the Company's investment from May 31, 2016 to May 31, 2017 and then averages these 13 monthly amounts to approximate a mid-point investment that produces the return on investment over the 12 months ended May 31, 2017.

²⁴ Pre-Hearing Brief, Page 4. Internal Revenue Code § 168(i)(9)(B) provides:

(i) In general. One way in which the requirements of subparagraph (A) are not met is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with the requirements of subparagraph (A).

(ii) Use of inconsistent estimates and projections. The procedures and adjustments which are to be treated as inconsistent for purposes of clause (i) shall include any procedure or adjustment for ratemaking purposes which uses an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under subparagraph (A)(ii) unless such

the accuracy of Atmos' contentions. Atmos does cite and very briefly explain a number of private letter rulings²⁵ in the context of the Consistency Rule that are factually dissimilar to the ARM process. None of the rulings addresses a case like the ARM process here in which a budget filing is made that, if approved, puts new rates into effect, with that budget filing being trued up to actual results by means of a separate reconciliation filing, and with the adjustment amount resulting from the reconciliation filing being included in the next budget filing.²⁶

In the absence of direct support or authority with similar facts, Atmos next turns to three hypotheticals that, from the Consumer Advocate's perspective, do not appear to reflect the operation of the overall ARM process that includes both the reconciliation and budget processes. These factually unsupported hypotheticals take the form of three claims of how a normalization violation could allegedly occur in this Reconciliation Docket.²⁷

Atmos' first claim is that "ADIT used to reduce rate base cannot exceed the amount for the period used in determining tax expense. The Consumer Advocate's position would measure the ADIT by which rate base is reduced as of May 31, 2017, while tax expense is measured during the period October 1, 2015 through September 30, 2016. Thus, at least some of the ADIT balance as of May 31, 2017, will not have been reflected in tax expense as measured for the

estimate or projection is also used, for ratemaking purposes, with respect to the other 2 such items and with respect to the rate base.

²⁵ Pre-Hearing Brief, Page 5.

²⁶ Since no rates are put into effect in the Reconciliation Docket, Atmos' apparent reliance on private letter rulings that do not reflect the facts here to show a tax normalization violation appears to be misplaced. By their own terms, private letter rulings are factual in nature and the results and tests they provide must be viewed in the context of the facts presented. None of the private letter rulings cited contain facts reflecting an ARM like the one here – that is, a budget filing that puts rates into effect that is adjusted (by a one line adjustment) by the results of a reconciliation docket that does not put rates into effect. Likewise, since the private letter rulings do not contain facts like those here, it must be questioned whether the analysis in the private letter rulings applies to the ARM. Specifically, if the facts are not the same, would the analysis – or even the tests – change in the context of an ARM process?

²⁷ In its claims of violations of the Limitation and Consistency tests in these hypotheticals, Atmos assumes that the point in time at which the Limitation and Consistency tests are applied would be in the reconciliation docket in the context of an ARM process. This assumption does not appear to be included in the Treasury Regulations or private letter rulings cited by Atmos.

Company's 2016 fiscal year."²⁸ Second, Atmos claims that "the ADIT balance as of May 31, 2017 will contain deferred taxes created by plant that was not even owned by the Company during its 2016 fiscal year but was acquired between October 1, 2016 and May 31, 2017."²⁹ Third, Atmos claims that "even in the case of assets that were owned by Atmos Energy during that earlier period, the May 31, 2017 ADIT balance will include deferred taxes produced by book and tax depreciation that occurred after the end of the Company's 2016 fiscal year."³⁰ It is again important to emphasize that Atmos provides no data – or much analysis – and cites no direct authority in support of its apparent belief that these claims result in a tax normalization violation.³¹

In response to these claims, it initially should be again noted for context that, under the ARM, a budget filing is made on February 1 of each year that puts new rates into effect on June 1 of each year. The budget filing is trued up to actual results by means of a reconciliation filing on September 1 of each year, with the adjustment amount coming out of the reconciliation filing being included in the next budget filing. In other words, the ARM represents a continuing true-up of rates – not a one-time adjustment to base rates from a rate case.

With that background and timeline, and since Atmos has chosen to address this in the form of hypotheticals, it appears that the question actually raised by Atmos' claims is: At what point are the accounting measurements made that determine whether or not a company is in compliance with the normalization rules? Atmos Pre-Hearing Brief does not directly address

²⁸ *Id.*

²⁹ Pre-Hearing Brief, Page 6.

³⁰ *Id.*

³¹ To address the technical aspects of the three claims, the Consumer Advocate notes that Atmos alleges that the Consumer Advocate has somehow "mismatched" the accumulated deferred income tax liability that is recorded on the Company's books at May 31, 2017 with the income tax expense that was recorded on the books at September 30, 2016 (the Company's fiscal year-end). This statement is incorrect. Atmos' mismatch allegation appears to skip over the overall point of the ARM – that is, to recognize the rate of return for the 12 months ended May 31st and then compare that actual achieved rate of return with the return authorized by the Commission to determine if there is a revenue surplus or deficiency that needs to be reflected in rates.

this question, except in the sense that it arguably attempts to defend a normalization determination in the reconciliation docket. To the Consumer Advocate, though, there appear to be at least three points in time at which that measurement could occur. The first point would be in the general rate case that established methodologies that would be followed in an ARM process – as relevant here, that would be Docket No. 14-00146. The second point would be in the budget process when rates (originally set in the most recent general rate case) are annually adjusted and put into effect. The third point would be in the reconciliation process that essentially trues-up the budget to the Company’s actual results (that is, the best available information on the Company’s books). Each of these points at which the measurement could occur could be said to be reflected in the positions taken by the Parties in this Reconciliation Docket.³²

The Consumer Advocate contends that the measurements related to the determination of compliance with the normalization rules occur at the general rate case and, in the context of the ARM process, perhaps in the budget process – that is, at the two points at which rates are set or adjusted. In other words, there does not appear to be a basis for evaluating compliance with the normalization rules in a reconciliation docket that does not change rates. In the Consumer Advocate’s view, the reconciliation docket, as here, serves merely as mechanism to true-up the budget that has already been put into rates to the actual results that the Company realized over the course of the relevant budget year. It was not contemplated by the Consumer Advocate that any account would be simply re-calculated,³³ along the lines of the budget process. The

³² Atmos, as noted above, offers an essentially unsupported defense of the determination being made in this Reconciliation Docket.

³³ Atmos does not seem to have contemplated – at least initially – how the process would work. Waller, in response to a question at the hearing about whether Atmos agreed to the 14-00146 Settlement Agreement knowing it required income tax “actual results” entries as of May 31, stated that Atmos “had not – we had not contemplated exactly how we were going to make the true-up entries related to income taxes of the day – on the day we signed the settlement agreement in [Docket No. 14-00]146.” Hearing Transcript, Page 56, lines 13-17. Yet in the first reconciliation

Consumer Advocate contemplated that the reconciliation docket would use the actual results from the Company's books.³⁴ This per-books actual results methodology has been followed by Atmos in every account except for income tax expense. It is worth noting that, in the Consumer Advocate's view, this approach would have been followed with respect to income tax expense if Atmos kept its accounting records in accordance with methodologies approved in the general rate case, as confirmed by the first reconciliation docket.³⁵

Atmos' apparent unwillingness to keep its accounting records in accordance with the spirit and language of the approved methodologies, in the view of the Consumer Advocate, has caused a more fundamental analysis of the ARM process, and in particular the nature of the budget and reconciliation processes. In that context, the Consumer Advocate contends that the strongest theoretical position is that rates are set in the general rate case and the ARM process is essentially nothing more than a surcharge that is reviewed and reconciled annually.³⁶ That surcharge is adjusted once a year when "new" rates are put into effect as a result of the approval of a budget filing that, in turn, reflects in part a true-up to the actual results that Atmos experienced during the immediately preceding budget period. That true-up essentially serves as an audit that is based on agreed procedures – in this case, those procedures are reconciling the amounts put into rates as essentially a surcharge with the actual results the Company experienced. In that context, the budget and reconciliation processes would not need to align perfectly in terms of compliance with the normalization rules – that determination would have

docket, Docket No. 16-00105, Atmos apparently understood that actual results meant per-books amounts. Compare 16-00105 Settlement Agreement, Schedule 8, with Pre-Filed Testimony of Gregory K. Waller, Schedule 8, as filed in TPUC Docket No. 16-00105.

³⁴ See Novak Supplemental Testimony, Page 5, line 18, through Page 6, line 12.

³⁵ Atmos' recent Motion and Budget Date Petition support this position – and even Atmos admits that if its books matched the relevant period then there would be no normalization violation.

³⁶ While base rates are adjusted when Atmos' budget filing is approved, the Consumer Advocate believes this essentially is arguably the elevation of form over substance. Though it is nominally a change in base rates, in substance it is nothing more than base rates approved in the most recent general rate case adjusted annually by a surcharge.

already been made at the time of the general rate case and in connection with the approval of the methodologies that would be used in an ARM process.

Secondarily, the Consumer Advocate contends that the ARM process framework could support the position that the measurement of normalization compliance would be done in the budget process. This position has not been challenged by any Party. Since rates are set – or more precisely, adjusted, in the Consumer Advocate’s view – in the budget process, it would be defensible to consider normalization compliance in the budget process. In this sense, the budget process serves as mini-follow-up rate case in which rates are set based on an attrition period (the budget) that reflect the effects of a prior general rate case and the true-up to actual results experienced by the Company from the most recent budget period.

Thus, the issue raised by Atmos in this Reconciliation Docket – whether income tax expense must conform to the normalization rules in a reconciliation docket in the ARM process – does not appear to have been proven or even to be relevant in this Reconciliation Docket.

IV. ATMOS DOES NOT SHOW THAT ITS PROPOSED INCOME TAX EXPENSE METHODOLOGY WOULD TRUE-UP ITS BUDGET FILING TO ACTUAL RESULTS, OR THAT ITS PROPOSAL WOULD NOT RESULT IN A NORMALIZATION VIOLATION.

To faithfully reflect the ARM process, Atmos’ proposal – essentially a calculation that multiplies Atmos’ required revenue amount by Atmos’ statutory federal tax rate³⁷ – would appear to have to meet two fundamental requirements. The first would be that the amount resulting from the proposed calculation would have to reflect booked actual results. The second, in view of Atmos’ arguments, would be that the proposal not result in a normalization violation. Atmos does not demonstrate that its proposal meets either of these requirements.

³⁷ Waller Direct Testimony, Page 18, line 18, through Page 19, line 10 (referencing Story Direct Testimony).

A. Atmos Does Not Show that its Proposal Reflects Per-Books Actual Results.

On the first requirement, a review of Atmos' proposal in the context of the reconciliation process and in the context of the overall ARM process appears to raise questions about how its proposal – that is, required revenue times Atmos' statutory tax rate – reflects actual results, much less per-books actual results. In its Pre-Hearing Brief, Atmos offers no statement about how its proposal reflects actual results, though it does offer explanations in testimony.³⁸ In context of the reconciliation docket, though, questions could be asked about whether all amounts reflected on the Company's books match up with the budget year precisely, what is the relationship between Atmos' proposed calculation and the actual amount that would have been recorded on Atmos' books, and, in the larger context of the reconciliation and ARM processes, what are the larger aims of the reconciliation and ARM processes and what would be the effect of adopting Atmos' proposal?

The significant point Atmos attempts to make in its Pre-Hearing Brief on this issue is that income taxes recorded on the books at September 30, 2016 are not reflective of the taxes due from operations for the 12 months ended May 31, 2017. While it goes without saying that, by definition, those periods do not match up exactly, the differences in any amounts reflect only a timing difference that would be adjusted in the following period. Other accounts similarly reflect timing differences – that is, by their very nature, many of the accounts recorded on the books will never precisely match the exact ARM period. For example, property taxes recorded in February 2017 are based on the assessed value from a previous period. Likewise, employee bonuses paid at the end of the fiscal year are likely based on measured results from a previous period. As a result, there can never be a precise match for each and every expenditure item in an

³⁸ See, e.g., Story Direct Testimony, Page 4, line 22, through Page 6, line 5.

ARM, but the ARM considers these timing differences and makes adjustments for them in future periods.

Further, Atmos never demonstrates the relationship between its proposed calculation and the actual amount that would have been recorded on Atmos' books. Nor does Atmos clarify the critical relationships among its proposed calculated income tax expense and actual tax expense, regulatory tax expense, depreciation expense, and ADIT. Where does Atmos actually book – or even true up – the amounts resulting from its proposed income tax calculation? Or where does Atmos reconcile its proposed calculation amounts (and the implicit adjustments to the other accounts in them) to the actual books amounts? How would the amount resulting from the proposed calculation vary from an income tax expense that reflects all the entries that would be expected to go into that expense? If Atmos calculated income tax expense in accordance with its proposal, and reflected that expense in its books, would the resulting amounts of ADIT satisfy the tests described by the Treasury Regulations, Limitation, and Consistency Rule?

Turning from the theoretical problems Atmos' proposal presents³⁹ and refocusing on the practical aspects of the ARM statutes' aims, Atmos' reconciliation process seeks to recognize the rate of return for the 12 months ended May 31st and then to compare that actual achieved rate of return with the return authorized by the Commission to determine if there is a revenue surplus or deficiency that needs to be reflected as an adjustment to rates when they are put into effect. Atmos budget filing puts rates into effect, upon the approval of Atmos' budget filing (that includes the reconciliation adjustment), on June 1 of each year. No rates are put into effect at the

³⁹ With that context, Atmos makes a number of theoretical assumptions about how various accounts would interact in its attempt to show a tax normalization violation. Atmos further assumes that its regulatory accounting records match its theoretical assumptions. Nowhere does Atmos demonstrate that its regulatory accounting records match or correlate with the assumptions it makes. Thus, in the absence of Atmos' theoretical assumptions, Atmos does not demonstrate that the Limitation and Consistency tests are met in the context of the ARM process.

conclusion of the reconciliation filing. Rather, that adjustment is held for inclusion in a budget filing that is made and that would result in an adjustment to rates.

The aim of that adjustment for the current reconciliation Docket No. 17-00091, in the context of the ARM process, is to review the rate of return for the 12 months ended May 31, 2017. The rate of return is calculated by dividing net operating income for the 12 months ended May 31, 2017 by the average investment (rate base) for the 13 months ended May 31, 2017. In calculating the net operating income for the 12 months ended May 31, 2017, the Consumer Advocate examined all expenses (including income tax expense) for each month from June 1, 2016 through May 31, 2017. However, the Company only records income tax expense on their books at the end of their fiscal year which is September 30th. Consequently, the only income tax expense reflected in net operating income for the 12 months ended May 31, 2017 was the income tax expense that the Company recorded at September 30, 2016. So, the only available income tax expense that would represent an actual amount and would hence be usable in this Reconciliation Docket would be the income tax recorded on the Company's books at September 30, 2016.

In contrast, Atmos' proposal would obviate the actual results requirement by using a calculated amount that ties to nothing that could be considered actual results on the books of the Company. And if there is nothing that ties to the books, the best that could be said is that Atmos is attempting to simply have a budget amount included in its budget filing and a budget amount included in the reconciliation. The inability to confirm Atmos' calculated amount to the books or the relationships between tax expense per books, actual taxes paid, and ADIT demonstrates the failure of Atmos' proposal.

Thus, Atmos' proposal would not satisfy the first requirement that mandates the use of actual results.

B. Atmos Does Not Show that its Proposal Would Satisfy Tax Normalization Rules.

The second requirement, which includes aspects of first requirement, would require the satisfaction of the tax normalization rules. Atmos nowhere demonstrates that its proposal would satisfy the tax normalization requirements.⁴⁰ As alluded to earlier in analyzing the theory of Atmos' proposal and the relationships among the relevant accounts, Atmos appears to assume that a calculation based on its proposal would cause the alignment in actual tax expense, book tax expense, depreciation expense, and ADIT that it argues is required to avoid a tax normalization violation. That alleged alignment is shown nowhere. The absence of that demonstrated alignment cuts directly against Atmos' tax normalization issue being resolved by its proposal.

Perhaps illustrating the challenges that any alignment faces with respect to actual results and at least implicitly the tax normalization issue, Company witness Story essentially says, in the context of the actual results requirement, that September 30 per-book amounts are not trued-up for 9-10 months after the fiscal year-end, are merely estimates of income tax expense for the prior period, and would not be an appropriate amount to include as actual tax expense for the reconciliation revenue requirement.⁴¹ If September 30 amounts would face these challenges in satisfying the actual results and tax normalization problems, it would seem that Atmos' proposal would face similar challenges satisfying those requirements as well.

⁴⁰ The closest the Company appears to come to a statement along these lines would be in Company witness Story's rebuttal testimony in which she implies that changing to the Company's proposal to change to a required return times statutory rate calculation would meet the requirements of Revenue Procedure 2017-47 if the Company made that change and the Commission approved. Story Rebuttal Testimony, Page 12, line 19, through Page 13, line 3.

⁴¹ See Story Direct Testimony, Page 6, line 7, through Page 7, line 15.

With respect specifically to the tax normalization issue, albeit in the context of the Motion and Budget Date Petition – in which Atmos sought to change certain dates to align the budget and reconciliation years to a September 30 year-end, Atmos’ testimony illustrates the challenges with solving tax normalization issues.⁴² In Story’s rebuttal testimony in this Docket, Story references the testimonies of Waller and Novak,⁴³ indicates she has reviewed Waller’s proposal to change certain dates to reflect a period ending September 30,⁴⁴ and states that Waller’s proposal would eliminate the normalization violation issue because “the reserve and expense would be included for the same time period, the twelve months ending September.”⁴⁵ In contrast, in her hearing testimony, Story was not able to state without qualification that Waller’s proposal to change the dates to reflect a period ending September 30 would solve the tax normalization issues.⁴⁶ With this illustration, it would be appropriate to question Atmos’ lack of a statement clearly and unequivocally saying that its proposal would satisfy the tax normalization rules.

Thus, Atmos fails to show that its proposed income tax expense methodology would not result in a tax normalization violation.

⁴² In rebuttal testimony, Waller raises the income tax expense issue, notes the Consumer Advocate’s concerns, and asserts that moving the dates would “allow for the use of per-books income tax expense . . . that is synchronized with the end of the test period.” Waller Rebuttal Testimony, Page 14, lines 1-18. In contrast, in hearing testimony, Waller was unwilling to respond to specific questions about income tax expense or even whether Atmos could make the accounting adjustments it had agreed to make in the 14-00146 Settlement Agreement.

⁴³ Waller Rebuttal Testimony and Novak Supplemental Testimony.

⁴⁴ Waller Rebuttal Testimony, Pages 14-17.

⁴⁵ Story Rebuttal Testimony, Page 13, line 13 through Page 14, line 17. Also, note Story’s use of the annual period for her analysis and that her statement referencing the twelve months ending in September does not match the budget period described by Waller.

⁴⁶ Hearing Transcript, Page 122, line 4 through Page 123, line 3. Story’s rationale at the hearing was that the methodology by which the reconciliation period would be calculated has not been finalized, so it would depend on the methodology and calculations. *Id.*

V. NOTWITHSTANDING ATMOS' CHARACTERIZATION OF THE CONSUMER ADVOCATE'S POSITION AS RESULTING IN A TAX NORMALIZATION VIOLATION, ATMOS BEARS RESPONSIBILITY FOR ANY SUCH PROBLEM AND HAS NOT PRESENTED A VIABLE PROPOSAL TO SOLVE WHAT ATMOS BELIEVES TO BE AN ISSUE IN THIS RECONCILIATION DOCKET, AND HENCE, THE ARM PROCESS

Atmos has not explained how Atmos missed⁴⁷ what Atmos now claims is a serious tax normalization violation. As background, the 14-00146 Settlement Agreement requires that “actual results” be used to reconcile the prior budget that has been put into rates by Atmos under the ARM.⁴⁸ Subsequently, Atmos used per-books amounts in TPUC Docket No 16-00105 and the Commission Order in that Docket “found that the methodologies used by the parties in calculating the Revenue Deficiency pursuant to the ARM are consistent with those established by the [Commission] in [TPUC] Docket No. 14-00146.”⁴⁹

The clear meaning of “actual results” as a per-books approach is reflected in the 14-00146 Settlement Agreement, the application of that settlement agreement in the first reconciliation docket, and the Commission’s Order confirming that application. To the extent that Atmos now believes it has a problem, Atmos bears sole responsibility for not being aware of the meaning and implications of using “actual results” as it appears all the Parties understood it was going to be used – at least up to the filing of the current Reconciliation Docket. And it follows directly that Atmos bears responsibility for not continuing to follow through in this Docket to use “actual results” as was intended with the fiscal periods and deadlines that were agreed to and ordered in Docket Nos. 14-00146 and 16-00105.

⁴⁷ The Consumer Advocate believes that to the extent there may be a tax normalization violation, any such violation was solely within the control of Atmos to identify and prevent. As an example of the extent to which Atmos analyzed and reviewed the tax normalization issue in Docket No. 14-00146, see the Rebuttal Testimony of Pace McDonald, as filed in TPUC Docket No. 14-00146, as referenced in the Novak Supplemental Testimony, Page 10, line 8, through Page 11, line 2, and noting footnote 13.

⁴⁸ See 14-00146 Settlement Agreement, Page 26.

⁴⁹ Order Approving Settlement Agreement, in TPUC Docket No. 16-00105, Page 4.

The Consumer Advocate believes that the simplest and best solution would be for the Commission to require Atmos to follow through with the terms of 14-00146 Settlement Agreement and use a May 31 per-books tax expense amount in its reconciliation filings. Given Atmos' vast accounting and tax expertise, it does not appear credible that Atmos could not make the usable per-books tax entries as of May 31. This solution would resolve the "actual results" issue, and likewise would resolve the tax normalization issue. Atmos' own witness Waller acknowledged as much in response to a question at the hearing about whether this approach would work – Waller responded "[i]f it were possible to make entries, tax expense entries, on the same month end as the test period, then you're correct; that would – that would not cause a normalization violation if those entries were – if it was possible to make those entries that would be appropriate for ratemaking."⁵⁰

Interestingly, Waller stated that Atmos makes monthly depreciation entries⁵¹ and apparently inaccurate monthly tax entries,⁵² with the tax entries only being recorded once a year at the state level.⁵³ As noted above, the Consumer Advocate believes that the logical next step in the solution would be for Atmos to make accurate monthly tax entries as well. But Waller, who is Atmos' Manager, Rates and Regulatory Affairs, stated that he does not know if it would be possible for Atmos to make the accurate tax entries,⁵⁴ and deferred that question to Story. Story stated that Atmos makes monthly income tax entries, but that they are not accurate – based on the methodology that Atmos uses to calculate them.⁵⁵

⁵⁰ Hearing Transcript, Page 56, line 24, through Page 57, line 14.

⁵¹ Hearing Transcript, Page 58, line 23, through Page 59, line 15.

⁵² Hearing Transcript, Page 55, lines 4-15.

⁵³ Hearing Transcript, Page 59, lines 16-24.

⁵⁴ Hearing Transcript, Page 55, lines 16-20. Waller implies that income taxes are the only account that is not accounted for in a manner that would enable a monthly, and hence May 31, calculation of actual results on a per books basis.

⁵⁵ Hearing Transcript, Page 104, line 20, through Page 105, line 18. And all of this raises an additional question – what is the point of calculating the monthly tax amounts if Atmos believes that they are not accurate?

Left unsaid is whether a change to that methodology would enable Atmos to make useable tax entries. When pressed, Story was not able to say, without qualification, that making the actual results entries would not be possible.⁵⁶ With that in mind, and again considering the extensive resources and regulatory accounting and tax expertise of Atmos, it seems untenable to say that Atmos could not make the tax expense entries if it chose to make them. Thus, it would be appropriate for the Commission to require Atmos to do what Atmos agreed to do and make the monthly tax entries – and that would be the simplest and hence best way to solve the problem of Atmos’ own creation.⁵⁷

With that said, Atmos’ Pre-Hearing Brief says nothing of a solution along those lines, or any lines for that matter. In its Post-Hearing Brief in this Docket, filed February 9, 2018 (Post-Hearing Brief), Atmos rejects the use of May 31 book amounts in this Reconciliation Docket.⁵⁸ Atmos’ only other proposed solution is to use its required revenue in this reconciliation docket times its statutory tax rate.

For the reasons outlined above, that approach has not been shown to reflect actual results or to satisfy the requirements of the normalization rules. Thus, Atmos has not provided a viable proposal to solve what Atmos believes to be an issue in this Reconciliation Docket, and hence, the ARM process.

VI. CONCLUSION

Atmos has not demonstrated that a tax normalization violation would result from using per-books actual results in this Reconciliation Docket, or that this Reconciliation Docket is the

⁵⁶ Hearing Transcript, Page 106, line 14, through Page 107, line 14.

⁵⁷ If Atmos is unable or unwilling to make the necessary tax expense adjustments so that actual results can be matched with the proper regulatory period, it would appear appropriate to give serious consideration to whether Atmos should be permitted to continue to use the ARM set forth in Tenn. Code Ann. § 65-5-103(d)(6). With that in mind, it should be noted that Atmos availed itself of that regulatory rate-making alternative on the ground, in part, that the annual rate review would be made on the basis of actual results.

⁵⁸ Post-Hearing Brief, Page 6.

correct docket to determine compliance with the tax normalization rules. In addition, Atmos does not show that its proposed income tax expense methodology would true-up its budget filing to actual results, or that its proposal would not result in a normalization violation.

Finally, notwithstanding Atmos' characterization of the Consumer Advocate's position as resulting in a tax normalization violation, Atmos bears responsibility for any such problem and has not presented a viable proposal to solve what Atmos believes to be an issue in this reconciliation docket, and hence, the ARM process.

RESPECTFULLY SUBMITTED,



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This the 26th day of March, 2018.



Wayne M. Irvin