

BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION

NASHVILLE, TENNESSEE

August 1, 2018

IN RE:)	
)	
ATMOS ENERGY CORPORATION ANNUAL)	DOCKET NO.
RECONCILIATION OF ANNUAL REVIEW)	17-00091
MECHANISM)	

FINAL ORDER

This matter came before the Vice Chairman Robin Morrison, Commissioner Herbert H. Hilliard, and Commissioner Keith Jordan of the Tennessee Public Utility Commission (“Commission” or “TPUC”) at the Commission Conference on May 14, 2018, to consider the *Petition of Atmos Energy Corporation for Approval the 2017 Annual Reconciliation Filing* (“*Petition*”) filed by Atmos Energy Corporation (“Atmos” or “Company”) on August 31, 2017. The *Petition* was heard on the merits in a contested case previously on April 9, 2018.

BACKGROUND AND PETITION

On May 11, 2015, the Commission approved, in TPUC Docket No. 14-00146, a general rate increase and an Annual Rate Review Mechanism (“ARM,” “ARM Tariff” or the “mechanism”) for Atmos pursuant to the *Stipulation and Settlement Agreement* (“*Settlement Agreement*”) filed by Atmos and the Consumer Protection and Advocate Division of the Office of the Tennessee Attorney General and Reporter (“CPAD” or “Consumer Advocate”) on April 29, 2015. The *Settlement Agreement* provided that Atmos could opt into an annual review of its rates pursuant to Tenn. Code Ann. § 65-5-103(d)(6), with Atmos’ tariff outlining the specific

methodologies for the ARM.¹ The mechanism requires the Company to submit a rate adjustment in February of each year based upon its forward looking test year.² Subsequently, by September 1 of each year, the Company shall file with the Commission a reconciliation of actual results of its calculated authorized Return on Equity (“ROE”) to the forward looking test year just completed.³ The actual cost of service shall be compared to actual booked revenues to determine the revenue requirement adjustment necessary in order to achieve the authorized ROE.⁴

On August 31, 2017, Atmos filed the *Petition* in the present docket representing the second annual reconciliation filed under the Company’s approved ARM. As a component of the Company’s ARM, this filing reconciles actual operating results to those previously forecasted for the forward looking test year ending May 31, 2016.⁵ Pursuant to the ARM, any approved annual reconciliation revenue requirement would be included in the February 1, 2017 ARM Filing.⁶

On September 26, 2017, the CPAD filed a *Petition to Intervene*, which was granted by the Hearing Officer in an Order dated October 6, 2017. No other parties petitioned to intervene in this matter. The parties engaged in discovery and the Consumer Advocate submitted pre-filed testimony on December 4, 2017.

INCOME TAX CALCULATION METHODOLOGY

A dispute arose between the parties concerning the appropriateness of an income tax methodology proposed by the Company which was not previously utilized in the ARM reconciliation in TPUC Docket No. 16-00105. In its initial filing, the Company provided two separate income tax reconciliation calculations. On behalf of the Consumer Advocate, expert

¹ See *In re: Petition of Atmos Energy Corporation for a General Rate Increase Under T.C.A. 65-5-103(a) and Adoption of an Annual Rate Review Mechanism Under T.C.A. 65-5-103(d)(6)*, Docket No. 14-00146, *Stipulation and Settlement Agreement*, pp. 4-6 (April 29, 2015) (“*Atmos ARM Settlement Agreement*”).

² *Id.* at 4.

³ *Id.* at 26.

⁴ *Id.*

⁵ *Petition*, p. 2 (August 31, 2017).

⁶ *Settlement Agreement*, p. 27 (April 29, 2015).

witness William H. Novak explained in pre-filed direct testimony that the first of the two calculations was in a manner as agreed by the parties in the previous reconciliation filing in Docket No. 16-00105 which results in a negative adjustment of \$2,589,384.⁷ The second of the reconciliation calculations results in a positive adjustment of \$720,734. According to Mr. Novak, the second calculation is a change in methodology for calculating income taxes that excludes the “true-up to the actual recorded amounts on the ledger.”⁸ According to Mr. Novak’s pre-filed testimony, the Company did not mention a normalization violation or a statute or rule requiring a change in how income taxes were calculated.⁹ However, Mr. Novak stated, the Company later stated in discovery responses that a violation of income tax normalization rules requires the change.¹⁰

Mr. Novak’s pre-filed direct testimony opined that the Company had provided no testimony, Internal Revenue Service (“IRS”) ruling or private letter ruling or any other support that there was in fact a normalization violation.¹¹ Mr. Novak asserted that there was an alignment between accumulated deferred income taxes in rate base and deferred taxes included in tax expense with the ARM. Mr. Novak asserted that there was no requirement that the ARM reconciliation align with the Company’s fiscal year.¹² In the event the Commission determined the present ARM income tax calculation methodology results in a tax normalization violation, Mr. Novak urged the Commission to consider terminating the ARM and direct the Company to make an appropriate filing that avoids the issue.¹³

⁷ William H. Novak, Pre-filed Direct Testimony, p. 10 (December 4, 2017).

⁸ *Id.* at 10.

⁹ *Id.* at 12, 15-16.

¹⁰ *Id.*

¹¹ *Id.* at 16.

¹² *Id.* at 16-17.

¹³ *Id.* at 18.

Mr. Novak states it is “not possible to overstate the extent to which true-up to actual recorded amounts on the Company’s books was a core concept” of the settlement that resolved Docket No. 14-00146 and created the ARM.¹⁴ Mr. Novak also discussed the possibility of moving the reconciliation forward by four months to coincide with the Company’s fiscal year to relieve any normalization issue; however Mr. Novak cautioned that there were a number of complications such a change would entail and that it was unclear how a sixteen (16) month reconciliation period from June 2016 through September 2017 would be calculated.¹⁵

Pursuant to the procedural schedule, the Company submitted the pre-filed rebuttal testimony of Greg Waller and Jennifer Story on December 20, 2017. Mr. Waller contends that a specific income tax methodology was not addressed in the *Settlement Agreement* adopted by the Commission in Docket No. 14-00146 and therefore the methodology is governed by the paragraph outlining “Other Methodologies Adopted” in the *Settlement Agreement*.¹⁶ Mr. Waller asserts the Annual Reconciliation specifies only that previously forecasted cost of service items be replaced with actual results without actually defining “actual results” for income tax.¹⁷

Mr. Waller further asserts that all previous forward looking ARM filings have calculated income tax expense at statutory rates per the approved methodologies; and the one annual reconciliation filing in Docket No. 16-00105 used the per-book expense for the eight month period prior to the end of the test period in error.¹⁸ Atmos states that if the Company is directed to follow the recommendation of the Consumer Advocate, this error will continue in perpetuity

¹⁴ *Id.*

¹⁵ *Id.* at 19.

¹⁶ Gregory K. Waller, Pre-filed Rebuttal Testimony, p. 4 (December 21, 2017).

¹⁷ *Id.* at 4.

¹⁸ *Id.* at 5.

which is in conflict with paragraphs 18 and 19 of the *Settlement Agreement* which prohibit the use of the Settlement Agreement as a precedent in future proceedings.¹⁹

Atmos posited that Treas. Reg. § 1.167(1)-1(h)(6)(i) is very clear that the time period for income tax expense and Accumulated Deferred Income Tax (“ADIT”) must match.²⁰ Additionally, Ms. Story asserts that it is very time consuming and expensive to obtain a private letter ruling from the IRS. For these reasons, Ms. Story attests no further clarification is necessary or warranted.²¹ Ms. Story disagrees with Mr. Novak’s proposal to include per-books income tax expense balance for September 30, 2016, as she believes this will result in a clear misalignment between income tax expense included in the filing and the forecasted and reconciliation amounts.²²

In pre-filed rebuttal testimony filed on December 21, 2017, Mr. Waller indicated the Company had considered an alternative solution to the income tax issue of moving the reconciliation period forward as discussed briefly by Mr. Novak in his pre-filed direct testimony.²³ The Company recommended the Commission approve an alternative solution discussed by Mr. Waller; order the Company to re-file its reconciliation filing on January 23, 2018.²⁴ In addition, Mr. Waller’s pre-filed rebuttal testimony reflected concessions and agreements with some of the Consumer Advocate’s proposals and calculations which narrowed the number of contested issues between the parties primarily to the income tax expense calculation.²⁵

¹⁹ *Id.* at 3-5.

²⁰ Jennifer K. Story, Pre-filed Rebuttal Testimony, p. 4 (December 21, 2017).

²¹ *Id.*

²² *Id.* at 6-8.

²³ Gregory K. Waller, Pre-filed Rebuttal Testimony, p. 14 (December 21, 2017).

²⁴ *Id.* at 14-17.

²⁵ *Id.* at 9-13.

THE MOTION TO RESUBMIT RECONCILIATION AND CHANGE DATES

On January 8, 2018, Atmos filed the *Motion to Resubmit Reconciliation and Change Dates* (“*Motion to Resubmit*”) requesting a change in the ARM test year from June 1st through May 31st to October 1st through September 30th to align the test period with the Company’s fiscal year. Under the Company’s proposal, the Company would submit an ARM reconciliation filing covering June 1, 2016 through September 30, 2017 in a new docket as part of a new reconciliation filing. In making its request, Atmos proposed that issues between the parties concerning any specific methodology to reconcile the resulting 16-month reconciliation period could be reserved until the Company’s new ARM reconciliation filing.

Contemporaneously with the filing of the *Motion to Resubmit*, the Company filed a petition in Docket No. 18-00003 with the Commission requesting a shift in the Company’s ARM forward-looking filing date from February 1 to June 1; shift the forward-looking test year period to the period of October 1 through September 30; and shifting the implementation of new rates in the ARM process to October 1.²⁶ The *Motion to Resubmit* was heard before the voting panel of Commissioners during the regularly scheduled Commission Conference on January 16, 2018, and included testimony and cross-examination of Mr. Waller and Ms. Story.²⁷ Additionally, the parties submitted post-hearing briefs. At the Commission Conference on February 26, 2018, the panel deliberated and denied the *Motion to Resubmit*.²⁸

²⁶ See *In re: Atmos Energy Corporation Request to Change Certain ARM Dates*, Docket No. 18-00003, *Petition of Atmos Energy Corporation* (January 8, 2018).

²⁷ *Order Denying Atmos Energy Corporation’s Motion to Resubmit Reconciliation and Change Dates* (April 5, 2018).

²⁸ *Id.*

SCHEDULING THE HEARING ON THE MERITS

Following the panel's decision to deny the *Motion to Resubmit*, a hearing on the merits of the *Petition* was set for March 19, 2018.²⁹ On March 12, 2018, the Company filed a pre-hearing brief concerning tax normalization that was not contemplated under the procedural schedule then in effect. On March 13, 2018, the Consumer Advocate requested a status conference to confirm the scope of the docket in light of the Commission's ruling denying the *Motion to Resubmit*.³⁰ During a telephonic status conference on March 13, 2018, with the parties, the Hearing Officer confirmed it was her understanding that the Commission expected to hear testimony concerning the tax normalization dispute and that the hearing date would be moved to provide additional time for the Consumer Advocate to prepare for a hearing with respect to the tax normalization issue raised by the Company.³¹ The previously noticed hearing set for March 19, 2018, was canceled and the hearing on the merits was set for April 9, 2018.³²

THE MOTION IN LIMINE

In response to the Company's pre-hearing brief filed on March 12, 2019, the Consumer Advocate filed a pre-hearing reply brief and the Consumer Advocate's *Motion in Limine to Exclude Testimony on and Consideration of the Issue of the Alleged Tax Normalization Violation* ("*Motion in Limine*") on March 26, 2018. The basis of the *Motion in Limine* fixed on the hearing panel's decision denying the Company's *Motion to Resubmit*, specifically the panel's finding that the present docket is not the appropriate docket to resolve any potential tax normalization issue.³³

²⁹ *Notice of Hearing* (March 9, 2018).

³⁰ *Order Establishing Amended Procedural Schedule* (April 6, 2018).

³¹ *Id.*

³² *Re-Notice of Hearing*, (March 28, 2018)

³³ *Consumer Advocate's Motion in Limine to Exclude Testimony on and Consideration of the Issue of the Alleged Tax Normalization Violation*, pp. 2-3 (March 26, 2018).

The Hearing Officer denied the *Motion in Limine*. Among the grounds for denying the *Motion in Limine*, the Hearing Officer concluded that the Commission's *Order Denying Atmos Energy Corporation's Motion to Resubmit Reconciliation and Change Dates* issued on April 5, 2018, clarified that while any potential tax normalization violation should be corrected in the next rate proceeding, any potential normalization issue would impact the Company's next budget filing which was also held in abeyance, and that the Commission must continue to entertain any potential tax normalization issue in the present docket.³⁴

THE HEARING

The Hearing in this matter was held before the voting panel of Commissioners during the regularly scheduled Commission Conference on April 9, 2018, as noticed by the Commission on March 28, 2018. Participating in the Hearing were:

Atmos Energy Corporation – Scott Ross, Esq., Neal & Harwell, PLC, 1201 Demonbreun Street, Suite 1000, Nashville, Tennessee 37203.

Consumer Protection and Advocate Division – Wayne M. Irvin, Esq., and Vance Broemel, Esq., Office of the Tennessee Attorney General and Reporter, Post Office Box 20207, Nashville, Tennessee 37202-0207.

During the Hearing, Gregory Waller, manager of rates and regulatory affairs for Atmos, and Jennifer K. Story, Director of Income Tax for Atmos, provided a summary of their pre-filed testimony and were subject to cross examination by the Consumer Advocate. William H. Novak testified on behalf of the Consumer Advocate and subject to cross examination by the Company.

At the hearing, Atmos contended that the sole remaining issue in the docket is the tax issue and that the statutory rate of 35% should be used to determine federal income tax expense on pre-tax book income of approximately \$24 million.³⁵ The dispute represented a significant financial impact. Under the Consumer Advocate's position, the *Petition* would result in a

³⁴ *Order Denying Consumer Advocate's Motion in Limine*, pp. 3-4 (April 6, 2018).

³⁵ Transcript of Hearing, pp. 6-8 (April 9, 2018).

revenue surplus of roughly \$3.5 million versus an approximate revenue deficiency of \$382,000 under the Company's proposed methodology.³⁶

Mr. Waller testified that tax expense calculated using the statutory rates is representative of the actual results for the twelve months ending May 31, 2017, whereas using the booked tax expense represents the tax expense for nine months earlier at September 31, 2016, and is not associated with May 31, 2017 net income.³⁷ Mr. Waller conceded the Company made an error in the previous reconciliation filing in TPUC Docket No. 16-00105 by not following the methodology outlined in the *Settlement Agreement* reached in TPUC Docket No. 14-00146.³⁸ In this docket, however, Atmos contended it is calculating tax expense consistent with the requirements outlined in in Docket No. 14-00146 so that the previous error is not repeated.³⁹

Mr. Waller conceded that no rates will change at the conclusion of this docket but maintained that there is no future proceeding where the outcome of this proceeding can be revisited or adjusted before implementing rates. Therefore, he concluded the results of this docket would have an impact on future rates.⁴⁰ Mr. Waller claimed that in addition to violating rate making principles and logic, the misalignment from reconciling periods that end in May and September respectively results in a tax normalization violation.⁴¹ Mr. Waller stated that he is not a tax accountant, had not contemplated whether there was a tax normalization issue when he filed his pre-filed testimony in this docket and that the Company relied upon Ms. Story's testimony with respect to details and technical aspects of Atmos's calculation.⁴²

³⁶ *Id.* at 30-31.

³⁷ *Id.* at 26-29.

³⁸ *Id.* at 23-24, 47-48.

³⁹ *Id.* at 23-26.

⁴⁰ *Id.* at 34-39.

⁴¹ *Id.* at 26-28; 48.

⁴² *Id.* at 25-28; 48-49.

Ms. Story testified that the earnings of Atmos are taxed at the statutory tax rates in every jurisdiction it operates in, including Tennessee, and the calculation includes both current and deferred taxes.⁴³ Ms. Story explained that the structure of Atmos Corporation inhibits the Company from recording tax expense on the books of the regulated operations in Tennessee because all regulated operations are included in one corporation. According to Ms. Story, the Company records income tax expense on the books throughout the year; however, they do not record it at the regulated operating division level such as Tennessee.

Ms. Story concedes it would be possible to record at the regulated level but it would require additional resources and states again the end result would be the same.⁴⁴ The tax expense is recorded at the business unit levels rather than all seventy-two regulated operating divisions. Recording tax expense to all regulated divisions would require more accounting entries and obtaining agreement from the Company's auditors. While this could be done, Ms. Story claims the end result would be the same as the Company is proposing in this filing.⁴⁵

Ms. Story testified that it was the position of the Company that applying statutory rates would comply with the IRS's normalization requirements; however she conceded the normalization requirements aren't "written in such a way that they speak to specific types of calculations and them not being a normalization violation."⁴⁶ Ms. Story opined that the IRS is the only body that can determine whether a normalization violation has occurred.⁴⁷

Ms. Story testified that the normalization issue essentially is the synchronization of income tax expense in relation to ADIT along with depreciation expense and rate base.⁴⁸ She

⁴³ *Id.* at 52.

⁴⁴ *Id.* at 67-69.

⁴⁵ *Id.* at 55-57.

⁴⁶ *Id.* at 92.

⁴⁷ *Id.* at 93.

⁴⁸ *Id.* at 95.

claimed that the IRS safe harbor provisions for inadvertent normalization violations would no longer apply because the present docket is the opportunity to correct it and “we’ve talked about it” and are “aware of it.”⁴⁹ Ms. Story testified that she disagreed that using the September 2016 period tax expense for May 2017 tax expense will “wash out” as the Consumer Advocate proposes because there would be an eight month lag period for tax expense going forward.⁵⁰

On behalf of the Consumer Advocate, Mr. Novak stated the difference between the Company and the Consumer Advocate is related solely to the amount of federal income tax expense.⁵¹ Mr. Novak reiterated the Consumer Advocate’s position that calculating income taxes based on what the Company actually recorded on their books is the methodology established in the *Settlement Agreement* in TPUC Docket No. 14-00146 that established the ARM and the same methodology applied by the Company in the previous ARM reconciliation.⁵² Mr. Novak opines that the Consumer Advocate settled in TPUC Docket 14-00146 with a fundamental reliance on using methodologies based on actual recorded amounts in the Company’s books in ARM filings and he doubts a settlement could have been reached without this understanding.⁵³

Mr. Novak opines that the Company’s change in methodologies and claim that there is a tax normalization violation motivated the amount of money due to consumers.⁵⁴ Referencing the Company’s assertion of an IRS tax normalization violation, the Consumer Advocate proposes the resolution is to have Atmos seek a Private Letter Ruling (“PLR”) from the IRS. The Consumer Advocate argued the PLR would also help eliminate any future controversies for other

⁴⁹ *Id.* at 125-126.

⁵⁰ *Id.* at 124-125.

⁵¹ *Id.* at 131.

⁵² *Id.* at 131-132.

⁵³ *Id.* at 132.

⁵⁴ *Id.* at 132.

companies that may want to use an alternative regulation twelve month period different from the Company's fiscal twelve month period.⁵⁵ Mr. Novak asserts that because this is an ARM true-up and not a rate case there can be no tax normalization violation.⁵⁶

Mr. Novak conceded that the only determination of income tax expense in TPUC Docket No. 14-00146 was calculating income taxes at statutory rates.⁵⁷ Mr. Novak testified that he was unaware of any docket that calculated income tax expense at anything other than statutory rates other than the Company's reconciliation proceeding in TPUC Docket No. 16-00105, which was resolved with a settlement agreement between Atmos and the Consumer Advocate.⁵⁸

Before the conclusion of the hearing, members of the public were invited to make public comments. None sought recognition.

FINDINGS AND CONCLUSIONS

Based on the evidentiary record in this matter, the hearing panel found that it is not the duty of this Commission to issue an interpretation or ruling on IRS Treasury Regulations regarding synchronization of income tax expense and accumulated deferred federal income taxes. Both Atmos and Consumer Advocate are aware of the process for obtaining clarification such as an IRS revenue ruling or private letter ruling and the Company may employ that process at any time. The issue of whether a tax normalization violation necessitated a change in methodology or modifying the ARM itself was introduced fairly late in the procedural schedule by the Company. While the parties and the Commission invested resources and considerable time entertaining a potential issue of first impression with respect to the Tennessee alternative utility rate regulation mechanisms, ultimately the hearing panel determined the dispute between

⁵⁵ *Id.* at 18-22.

⁵⁶ *Id.* at 133.

⁵⁷ *Id.* at 151-152.

⁵⁸ *Id.* at 153.

the parties turned on whether the filing complies with the Company's tariff, the *Settlement Agreement* approved for Atmos ARM in TPUC Docket No. 14-00146 and previous rulings of this Commission regarding federal income tax calculations.

Here, the Consumer Advocate proposes that the Commission apply actual tax expense recorded end of May, 2017, as the Company applied in its previous reconciliation docket in TPUC Docket No. 16-00105. The Consumer Advocate asserts the *Settlement Agreement* in TPUC Docket No. 14-00146 requires the use of "actual results" for income tax expense. The Company proposes in this docket that the *Settlement Agreement* authorizes the use of statutory rates for calculation of tax expense.

Upon review of the Atmos ARM tariff, the panel found that the tariff language specifically requires the use of a calculation for federal income taxes rather than booked amounts. The panel found that there was not any language in the tariff or the *Settlement Agreement* resolving TPUC Docket No. 14-00146 that provides specific guidance as to how federal income tax was to be determined in the annual ARM filing. As there is no specific language regarding the specific methodology to be used in determining income tax expense, it should be governed by paragraph 13(m) of the *Settlement Agreement* in Docket No. 14-00146 wherein it states:

To the extent that ratemaking methodologies are not described in this Settlement Agreement, the methodologies used in the Company's revenue requirement model and supporting workpapers and relied-upon files in this Docket No. 14-00146 may be utilized in calculating and evaluating the Company's annual revenue requirement and resulting sufficiency or deficiency.

The revenue requirement model and associated calculations approved in TPUC Docket No. 14-00146 clearly utilize statutory rates in calculating federal income taxes. The panel found that calculating federal income tax expense using the statutory rate of 35% is consistent with the

approved tariff language for the Atmos ARM. Moreover, this Commission has consistently calculated revenue requirements for income tax expense used to set utility rates by applying statutory tax rates rather than booked amounts, taking into account factors such as long standing federal tax policy and the underlying the rationales for deferred taxes for public utilities. For these reasons, the panel unanimously voted to approve the proposal of Atmos to calculate the federal income tax using statutory rates to be compliant with the approved ARM tariff and the *Settlement Agreement* of the parties as submitted in TPUC Docket No. 14-00146.


Based upon the preceding findings and approving those issues no longer contested by the parties, the panel voted unanimously that it is appropriate to use the revised ARM calculation submitted by Atmos calculating a revenue deficiency of \$382,182 for the period of June 1, 2016 through May 31, 2017. This calculation utilizes the methodology consistent with the original filing in TPUC Docket No. 14-00146 and is inclusive of the agreement of the parties on all other issues. The stay granted by the panel for the Required Budget Filing due on February 1, 2018, is lifted.

IT IS THEREFORE ORDERED THAT:

1. The revenue deficiency of \$382,182 for the period of June 1, 2016 through May 31, 2017 is approved.
2. The stay granted for the Required Budget Filing by Atmos Energy Corporation due on February 1, 2018, is lifted.
3. Any person who is aggrieved by the Commission's decision in this matter may file a Petition for Reconsideration with the Commission within fifteen days from the date of this Order.

4. Any person who is aggrieved by the Commission's decision in this matter has the right to judicial review by filing a Petition for Review in the Tennessee Court of Appeals, Middle Section, within sixty days from the date of this Order.

Vice Chairman Robin L. Morrison, Commissioner Herbert H. Hilliard and Commissioner Keith Jordan concur.

ATTEST: 

Earl R. Taylor, Executive Director