

**BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION
NASHVILLE, TENNESSEE**

IN RE:

**ATMOS ENERGY CORPORATION)
ANNUAL RECONCILIATION) DOCKET NO. 17-00091
OF ANNUAL REVIEW MECHANISM)**

AND

IN RE:

**ATMOS ENERGY CORPORATION)
REQUEST TO CHANGE CERTAIN ARM) DOCKET NO. 18-00003
DATES)**

POST-HEARING BRIEF OF ATMOS ENERGY CORPORATION

In this ARM reconciliation, Atmos Energy (“Atmos Energy” or “the Company”) seeks to resolve an eight-month misalignment between the test year being reconciled and the income tax figures used in the reconciliation. Atmos Energy discovered this misalignment when it was preparing its Petition. The misalignment occurs because the test year in Atmos Energy’s ARM tariff starts June 1, but the Company’s fiscal year starts October 1. The Company only records actual income tax expense to its books at fiscal year’s end, September 30. When the Company reconciles its June 1 test year, therefore, the most recent actual booked income tax figures cover the fiscal year ending eight months earlier.

There are two ways to fix this eight-month misalignment. The first would be to calculate income taxes at statutory tax rates, the method used in Atmos Energy’s rate cases for years, and in Docket 14-00146. The Company’s Petition in this docket proposed this first approach. But it met with stiff resistance for failing to start with tax figures taken from the Company’s general

ledger. Atmos Energy therefore proposes the second solution. That is, the Company's ARM test year be shifted eight months, to align with its October 1 fiscal year. In so doing, Atmos Energy can use fiscal-year-end tax figures without having an eight-month misalignment. The new ARM test year would run October 1 to September 30; the forward-looking ARM filings would be made on June 1; new rates would be implemented October 1; and ARM reconciliation dockets would be filed on January 15.

As an initial step, Atmos Energy filed the Motion now under consideration. The Motion is narrow, seeking to administratively close this docket, and for the Company to submit a new reconciliation petition covering the period June 1, 2016 through September 30, 2017. The Motion specifically reserves for later determination all other issues raised in this docket, and all issues concerning specific methods for reconciling the transitional four-month "stub" period. These issues would be subject to fulsome discovery and consideration in the to-be-filed reconciliation docket. As a further step, Atmos Energy also filed a Petition (18-00003) to make corresponding date changes to its ARM Tariff and forward-looking filings. Specifically, Atmos Energy's Petition seeks to delay its February 1 ARM forward-looking filing to June 1, to align the test period with the Company's fiscal year (October 1, 2018 through September 30, 2019) and to implement resulting new rates effective October 1, 2018.

Income tax expense from a prior period should not be used to reconcile the revenue requirement from a later one. Income tax expense should synchronize with income. Currently it does not, and Atmos Energy's Motion and Petition are proper steps toward fixing that problem. As discussed below, the Commission has ample authority to grant the relief requested. For the reasons discussed herein and on the record of these dockets, Atmos Energy respectfully submits that its Motion should be granted.

DISCUSSION

Atmos Energy's Annual Review Mechanism ("ARM") tariff was adopted in Docket No. 14-00146. That Docket was forward-looking, as were all of Atmos Energy's Tennessee rate setting dockets up to that point. As a result, income taxes in Docket No. 14-00146 (and in the Company's prior rate cases) were calculated by applying statutory tax rates to forecasted income. The text of the Settlement Agreement in Docket No. 14-00146 did not specify how income taxes would be determined. Waller 1/16/2018 at 75. Instead, it generally incorporated the attached schedules showing how the company would forecast the forward-looking test year: "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 . . ." Settlement Agreement, Docket No. 14-00146 at 25, para. 13(m); Hearing Testimony of Gregory K. Waller, January 16, 2018 (hereinafter "Waller 1/16/2018") at 75. Workpaper 8-2 in turn calculated income taxes using statutory tax rates. Waller 1/16/2018. In this manner, income tax expense was synchronized with revenue. *Id.* at 76. The Settlement Agreement also incorporated an annual reconciliation proceeding, and for that it provided: "The annual reconciliation shall include a calculation of actual cost of service, determined in accordance with the Approved Methodologies, for the Forward Looking Test Year immediately completed; using the same revenue requirement model used in each Annual ARM Filing, substituting actual results in place of previously forecasted data for all aspects of cost of service, excluding revenue calculations." *Id.* at 26, para. 14(b). No more specific guidance was provided on how to handle income taxes in the reconciliation filings. And nothing in Docket No. 14-00146 said anything specific about how the Company would determine "actual results" for income taxes during the June 1 test year, when the Company's

actual income tax expense is only determined and recorded at fiscal-year end, eight months earlier. *See* Waller 1/16/2018 at 31-32; *see also* Rebuttal Testimony of Gregory K. Waller, filed December 20, 2017, at 4-6.

When the Company completed its first and (prior to this docket) only reconciliation proceeding (Docket No. 16-00105), it replaced the calculated income tax formulas in its annual revenue model with income tax figures taken from its books. Doing so was an error, one the Company did not recognize until it prepared the reconciliation in this case, and one the Company now seeks to fix, not perpetuate. Waller 1/16/2018 at 21. Docket No. 16-00105 was resolved by settlement. And contrary to some of the Consumer Advocate's arguments here, that settlement agreement contained two paragraphs expressly providing that matters resolved there would not be cited as binding in future dockets:

18. This Settlement Agreement shall not have any precedential effect in any future proceeding or be binding on any of the Parties in this or any other jurisdiction except to the limited extent necessary to implement the provisions hereof.

19. The Parties agree and request the TRA to order that the settlement of any issue pursuant to this Settlement Agreement shall not be cited by the Parties or any other entity as binding precedent in any other proceeding before the TRA or any court, state or federal except to the limited extent necessary to implement the provisions hereof.

Settlement Agreement, Docket No. 16-00105, at 9; *see also* Waller 1/16/2018 at 76-77. Docket No. 16-00105 was the Company's first and only use of an actual income tax expense figure; the Company's prior Tennessee dockets were forward-looking, and calculated income tax expense based upon statutory tax rates, as did the Settlement Agreement in Docket 14-00146. Waller 1/16/2018 at 76.

In its preparation of this annual reconciliation proceeding, the Company's second, Atmos Energy discovered its error in using income tax figures taken from its fiscal-year-end books,

reflecting tax expense for a period ending eight months earlier than the one being reconciled. Waller 1/16/2018 at 21. As discussed in more detail in both pre-filed and hearing testimony, those September 30 book tax figures did not reflect the actual income tax expense associated with the Company's income during the June 1 to May 31 test period being reconciled. Waller 1/16/2018 at 21, 29; Pre-filed Testimony of Jennifer K. Story, August 31, 2017, at 5-7. "Income tax expense recorded on the Company's books for the period ending September 30, 2016 in no way relates to the cost of service included in the test year." Story, *supra* at 7. The test period includes eight more months of investment, and, therefore, eight more months of return; it therefore requires eight more months of tax expense than at fiscal-year-end September 30. Waller 1/16/2018 at 21, 29. This eight-month lag will not self-correct, but rather would be expected to continue because Atmos Energy adds investment each year in Tennessee, and its rate base, returns, and income tax expense correspondingly grow over time. And because Atmos Energy's forward-looking ARM filings project income tax expense by applying statutory tax rates, every year's reconciliation proceeding would require a significant downward adjustment to properly forecasted income tax expense if the Company were forced to apply income tax expense for a period ending eight months earlier than the one being reconciled. The failure to synchronize tax expense with revenue for the period being reconciled also results in a normalization violation, which the Company seeks to correct. Hearing Testimony of Jennifer Story, January 16, 2018 (hereinafter "Story 1/16/2018) at 86 *et seq.*; Atmos Energy Response to DR 4-44, filed November 15, 2017.

Atmos Energy records income tax expense in accordance with generally accepted accounting principles ("GAAP"). Story 1/16/2018 at 80. Following GAAP, on a monthly basis the Company records only high-level, Company-wide estimates of income tax expense, applying

a rate from the previous quarter to current monthly earnings. Story 1/16/2018 at 80. These monthly estimates are not accurate enough to determine tax expense for ratemaking purposes. Waller 1/16/2018 at 30. Only at fiscal year's end, after its book numbers are finalized, is the Company able to calculate a complete and detailed income tax expense number for each of its divisions. Story 1/16/2018 at 80. Until that time, the amounts recorded on the Company's financial statements are based on very high-level estimates. *Id.*; Waller 1/16/2018 at 31. Contrary to the Consumer Advocate's suggestion, therefore, it is no answer simply to say that the Company should make a book entry for income tax expense for the June 1 to May 31 period. As the Company's Director of Income Tax testified without contradiction, "I do not believe that we have the ability to record income tax expense in the May time frame that would align with the revenues for a 12-month period ending in May for the – for the ARM. . . . I can't envision how that would work, as it doesn't follow generally accepted accounting principles." Story 1/16/2018 at 81-82.

This leaves two ways to re-synchronize income tax expense with income for the period begin reconciled: calculate income tax expense by applying statutory tax rates to actual revenue for the test year being reconciled; or move the test year dates to synchronize with the Company's fiscal year. In its reconciliation Petition here, the Company proposed the first – that is, to calculate income tax expense using statutory tax rates. That approach properly determines the amounts of current and deferred income taxes resulting from the revenue requirement reflected in the reconciliation filing. Pre-Filed Testimony of Jennifer K. Story, August 31, 2017, at 4. It aligns income tax liability incurred by the Company with the operations included in the revenue requirement for the test year being reconciled (June 1 to May 31), and, therefore, results in matching of the income tax included in the reconciliation filing with the revenues that gave rise

to the income tax liability. *Id.* It is fully consistent with the Company's ARM Tariff as adopted in Docket No. 14-00146. As discussed above, the 14-00146 Settlement Agreement model calculated income tax by applying statutory rates to income. *See* Settlement Agreement, Docket No. 14-00146, Workpaper 8-2.

However, the Company's proposal to calculate taxes at statutory rates was vigorously opposed for failure to start with a tax figure sourced from the Company's general ledger. Waller 1/16/2018 at 21-22. The Company therefore considered the only other option – that is, to move the ARM test year dates to synchronize with the Company's fiscal year. *Id.*; *see also* Waller Rebuttal Testimony at 14 *et seq.*; Novak January 4 Testimony at 14-15. The Company's ARM test year would be changed from a June 1 start to an October 1 start, to synchronize with the Company's fiscal year. The Company's other ARM dates would be shifted by a similar amount. Future ARM reconciliation dockets like this one would be filed on or before January 15. The forward-looking ARM filings would be made on or before each June 1, and new rates would be implemented October 1. A redline showing these proposed date changes to the ARM Tariff was filed as Exhibit GKW-R-2 to the Rebuttal Testimony of Gregory K. Waller (filed December 20, 2017).

The public interest will be served by synchronizing income tax expense with income. The ARM statute, Tenn. Code Ann. § 65-5-103(d)(6), provides a mechanism by which rates will be adjusted annually such that a utility can earn its approved rate of return. A mechanism that systematically under-reports a legitimate expense item (here income tax expense) also systematically denies the utility the ability to earn its approved rate of return. This undermines the statutory mechanism and is contrary to the public interest in fair and efficient rate regulation. Measuring income tax expense over a prior period would systematically deny recovery of costs

actually incurred during the period under review, and therefore systematically deny the rate of return deemed reasonable in Docket No. 14-00146. *Cf. S. Bell Tel. & Tel. Co. v. Tennessee Pub. Serv. Comm'n*, 202 Tenn. 465, 480, 304 S.W.2d 640, 646 (1957) (rates did not allow just and reasonable rate of return in part because they did not recognize increase in utility's ad valorem tax costs). Shifting the ARM dates resolves this tax synchronization problem, allowing fiscal-year-end book tax expense figures to be utilized in reconciling a corresponding ARM test period.

Atmos Energy understands that questions remain about transition to and implementation of the new ARM test and reconciliation periods. The Company appreciates the Consumer Advocate's questions about exactly how the transitional four-month "stub" period will be reconciled. Mr. Waller responded to such questions at the January 16 hearing. *See, e.g., Waller 1/16/2018 at 40-41, 43* (explaining that the Company's rates have been reviewed more often than annually, that there are two years of approved forward-looking filings, and that the four-month stub period overlaps with those prior filings). As Mr. Waller emphasized, the Company is not asking the Commission to rule on such questions in this docket. *Id.* at 23, 49. Rather, the Company's Motion requests that all such questions be reserved for full exploration and resolution in a new reconciliation docket. *Id.* at 49. Indeed, the Company's Motion requests only that the ARM time periods and dates be changed to align them with the Company's fiscal year, and that all other issues be reserved for consideration in future dockets. In this way, all parties will have ample opportunity to conduct discovery and submit testimony and argument on all issues arising from the date changes, and the Commission can decide any contested issues after due consideration.

The Commission has ample authority to allow the ARM date changes requested by Atmos Energy in its Motion and corresponding Petition in Docket No. 18-00003. The ARM

statute itself expressly grants the Commission authority to modify an approved annual review plan, upon request from the utility, or on its own initiative:

The commission or *the public utility may propose a modification to the approved annual review plan for consideration by the commission*. The commission shall determine whether any proposed modification is in the public interest and should be approved within the time frame set forth in subdivision (d)(6)(C). If the commission denies a modification to the approved annual review plan, the commission shall set forth with specificity the reasons for its denial.

Tenn. Code Ann. § 65-5-103(d)(6)(D)(iii) (emphasis supplied). In its Order Approving Settlement in Docket No. 14-00146, in which Atmos Energy's ARM Tariff was approved, the Commission confirmed that the Settlement Agreement would not limit the Commission's authority under the ARM statute: "The Parties have confirmed through data requests that neither the *Settlement Agreement* nor the terms of the ARM tariff expands or limits the annual rate review statute or the Authority's rate-setting powers and discretion." Order Approving Settlement Agreement, Docket No. 14-00146, November 4, 2015, at 10. Consistent with the Commission's finding, the Settlement Agreement and the ARM Tariff not only preserve the Commission's authority to modify an approved ARM Tariff, but also expand it to allow a request for modification to be made by the Consumer Advocate. *See* Settlement Agreement, Docket No. 14-00146, at 28, para 16; Atmos Energy Tariff Sheet 34.7. All of this is fully consistent with the Commission's broad authority over rate-setting and administration. *See CF Indus. v. Tennessee Pub. Serv. Comm'n*, 599 S.W.2d 536, 542–43 (Tenn. 1980)); *see also* Tenn. Code Ann. § 65-4-106 ("any doubt as to the existence or extent of a power conferred on the commission by this chapter or chapters 1, 3 and 5 of this title shall be resolved in favor of the existence of the power, to the end that the commission may effectively govern and control the public utilities placed under its jurisdiction by this chapter"). And it is consistent with past practice under Atmos Energy's own ARM Tariff; methodologies specified in the Settlement Agreement have been

changed at the request of the Consumer Advocate. Waller 1/16/2018 at 67 (referencing change to methodology regarding capitalized incentive compensation); Settlement Agreement in Docket No. 16-00105 at 4-6, paras. 9-11 (same).

CONCLUSION

Income tax expense amounts used to reconcile the test period should come from that period, not an earlier one. Atmos Energy's Motion is a sound step toward that end, and should be granted.

Now therefore, based upon the foregoing, and the entire record in this case, Atmos Energy respectfully requests that the Commission approve the following specific relief in Docket No. 17-00091:

1. Atmos Energy be allowed to file a new ARM reconciliation covering the period June 1, 2016 through September 30, 2017;
2. This new ARM reconciliation filing be made under a new docket number, through the filing of a new reconciliation petition;
3. Issues concerning the specifics of the reconciliation calculations be reserved, to be addressed in the Company's new ARM reconciliation filing; and
4. All other issues raised in Docket No. 17-00091 be reserved for resolution in the new reconciliation docket, or in another docket, and Docket No. 17-00091 be administratively closed.

Consistent with the proposed tariff amendments attached as Exhibit GKW-R-2 to the Rebuttal Testimony of Gregory K. Waller (filed December 20, 2017 in Docket No. 17-00091 and incorporated by reference in Docket No. 18-00003), Atmos Energy also respectfully requests that

the Commission approve the following amendments to the Company's ARM tariff in Docket No. 18-00003:

5. To shift the Company's ARM forward-looking filing date from February 1 to June 1, beginning with the Company's June 1, 2018 filing;
6. To shift the forward-looking test year period for the forward-looking filing to the period October 1 through September 30 (for the June 1, 2018 filing the period would be October 1, 2018 through September 30, 2019);
7. To shift the implementation date for resulting new rates to October 1 (for the June 1, 2018 filing, rates would be effective October 1, 2018); and
8. To shift the annual ARM reconciliation filing date to January 15.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing has been served, via the method(s) indicated below, on the following counsel of record, this the 9th day of February, 2018.

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