BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION
NASHVILLE, TENNESSEE

IN RE:

PETITION OF ATMOS ENERGY CORPORATION	**)**
FOR APPROVAL OF ITS 2018 ANNUAL RATE	**) DOCKET NO. 18-00067**
REVIEW FILING PURSUANT TO TENN.	**)**
CODE ANN. § 65-5-103(d)(6)	**)**

PRE-FILED TESTIMONY OF GREGORY K. WALLER ON BEHALF OF ATMOS ENERGY CORPORATION IN RESPONSE TO QUESTIONS INCLUDED IN AUGUST 28, 2018 ORDER ESTABLISHING PROCEDURAL SCHEDULE

I. INTRODUCTION OF WITNESS

Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.

A. My name is Gregory K. Waller. I am Manager, Rates and Regulatory Affairs with Atmos Energy Corporation ("Atmos Energy" or "Company"). My business address is 5420 LBJ Freeway, Ste. 1600, Dallas, Texas 75240.

Q. ARE YOU THE SAME GREG WALLER THAT FILED PRE-FILED TESTIMONY IN THIS DOCKET?

A. Yes.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to respond to three questions included in the Order Establishing Procedural Schedule entered August 28, 2018. Each of the questions is reproduced below, followed by the Company's response.

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. Forward looking treatment in rate cases ensures that the timing of revenues collected from customers aligns with the timing of a utility's cost of service. The methodology has been applied in setting rates for the Company in Tennessee without exception for many years, including Docket No. 14-00146. As a result, Tenn. Code Ann. § 65-5-103(d)(6) requires that forward looking methodologies be utilized in the Company's annual review mechanism. Eliminating the Forward Looking Test Year filing requirement without making additional modifications would result in an alternative regulation mechanism that systematically prevents the Company from earning its authorized return on equity ("ROE") by introducing regulatory lag into the ratemaking equation.

While the interest rate applied to the Annual Reconciliation Revenue Requirement ("ARRR") was intended to be a relatively minor component of the Company's rates (because the Approved Methodologies were designed to forecast cost of service with as much accuracy as possible), elimination of forward looking treatment would cause the interest rate to become (in some form or fashion) the primary instrument used to eliminate regulatory lag.

The Company is willing to pursue modifications to its ARM tariff that would result in a single filing per year. The single filing mechanism however, if adopted, must include a single filing that eliminates regulatory lag either through forward looking treatment or some other means so as to allow the Company to earn its authorized return on equity, as required by Tenn. Code Ann. § 65-5-103(d)(6).

The Company believes that finding such a solution should be attained through a collaborative effort involving all interested parties in order to be sustainable.

III. FORWARD LOOKING TEST YEAR FILING REQUIREMENT

Whether the Annual Review Mechanism should be modified to eliminate (a) the Forward Looking Test Year filing requirement and (b) the associated annual rate adjustment based on the Forward Looking Test Year filing; while retaining (c) the Annual Reconciliation of actual results to the Authorized Return on Equity and (d) the associated annual rate adjustment based on the Annual Reconciliation Revenue Requirement necessary to adjust the actual return on equity to the Authorized Return on Equity for the year immediately completed, all determined in accordance with the Approved Methodologies. Please discuss the rationale, including advantages and disadvantages, of retaining or eliminating the Forward Looking Test Year filing requirement and associated annual rate adjustment based on the Forward Looking Test Year filing. If the Forward Looking Test Year filing requirement and associated annual rate adjustment based on the Forward Looking Test Year filing are eliminated, please set forth with specificity and discuss in detail the changes to the Company's tariff and/or Approved Methodologies necessary to implement this modification.

Q. SHOULD THE ANNUAL REVIEW MECHANISM BE MODIFIED TO ELIMINATE THE FORWARD LOOKING TEST YEAR FILING REQUIREMENT AND THE ASSOCIATED ANNUAL RATE ADJUSTMENT?

A. No. This would serve to remove forward looking treatment from the Annual Review Mechanism.

Q. WHAT IS THE SIGNIFICANCE OF FORWARD LOOKING TREATMENT IN RATEMAKING?

A. Forward looking treatment, as generally described in the context of rate of return regulation, entails forecasting cost of service components and implementing rates such that the timing of the Company's revenues collected from customers aligns with the timing of its cost of service. In allowing such treatment, regulators ensure that the rates customers are paying reflect the utility's cost of service and the value of investment provided during the same time period.

Q. DOES EXISITNG TENNESSEE STATUTE ALLOW FORWARD LOOKING TREATMENT?

A. Yes. Tenn. Code Ann. § 65-5-103 allows for forward looking treatment in rate proceedings for the utilities regulated by the Tennessee Public Utility Commission ("TPUC" or "Commission"). Atmos Energy's Tennessee rates have been set on a forward looking basis going back many years. They were set on a forward looking basis in the Company's most recent rate case, Docket 14-00146. Forward looking treatment was a fundamental part of the methodology adopted in that case. As a result, Tenn. Code Ann. § 65-5-103(d)(6) requires that those forward looking methodologies be utilized in the Company's annual review mechanism.

Q. DID THE COMPANY CONSIDER THE PROVISIONS OF TENN. CODE ANN. § 65-5-103 WHEN PROPOSING THE ALTERNATIVE REGULATION MECHANISM THAT IT FILED IN DOCKET NO. 14-00146?

A. Yes. Given that Tennessee law allows the TPUC to utilize forward looking treatment, which it had applied without exception for many years to the Company's Tennessee rate cases, the Company proposed an alternative regulation mechanism pursuant to Tennessee Code Annotated Section 65-5-103(d)(6) that maintained forward looking treatment and made it a cornerstone of its proposal. The Company viewed this proposal as consistent with the alternative regulation statute provision that prescribes "an annual review of its rates based upon the methodology adopted in its most recent rate case."

Q. WHAT WOULD BE THE DISADVANTAGES OF ELIMINATING THE FORWARD LOOKING TEST YEAR FILING REQUIREMENT?

A. Eliminating the forward looking test year filing requirement without making additional modifications (discussed below) would result in an alternative regulation mechanism that systematically prevents the Company from earning its authorized return on equity ("ROE"). Given the provision of the alternative regulation statute that rates be set so as "to provide that the public utility earns the authorized return on equity established in the public utility's most recent general rate case," elimination of the forward looking approach alone, without additional modifications, would be inconsistent with the requirements of that statute.

Q. WHAT CAUSES A FILING BASED ON HISTORIC COST OF SERVICE TO SYSTEMATICALLY PRODUCE REVENUES LOWER THAN THOSE REQUIRED TO ALLOW A UTILITY TO EARN ITS AUTHORIZED RETURN ON EQUITY?

A. Regulatory lag. If a Company must invest capital, experience depreciation on its investment, and support a given level of operating expenses in one time period but wait until a future time period to recover those costs, it cannot mathematically cover its total cost of service (including return) in a timely fashion. This is the definition of regulatory lag and it is especially harmful when a utility is in an era of increasing capital investment requirements (as is the case for virtually every public gas utility in America today). Atmos Energy's 2019 capital investment plan calls for investment that is approximately four times its forecasted level of depreciation. At that rate, regulatory lag would systematically cause the Company to fail to earn its authorized return, should the Forward Looking filing be eliminated.

Q. DID THE COMPANY'S PROPOSAL AS FILED IN DOCKET NO. 14-00146 SPECIFY ONE OR TWO ANNUAL FILINGS?

A. One per year. The concept of the second filing each year (the "Annual Reconciliation" filing) was incorporated as part of a compromise and settlement with the Consumer Protection and Advocate Division ("CPAD") of the Attorney General's Office. In order to achieve a settlement with the CPAD, the parties invested countless hours to develop a two filing per year mechanism to which both parties could agree.

Q. YOU ALREADY STATED THAT THE FORWARD LOOKING TEST YEAR FILING REQUIREMENT SHOULD NOT BE ELIMINATED. COULD IT BE MODIFIED TO REDUCE THE REQUIRED NUMBER OF FILINGS?

A. Possibly. The Company is willing to pursue modifications to its ARM tariff that would result in a single filing per year. The single filing mechanism however, if adopted, must include a single filing that eliminates regulatory lag either through forward looking treatment or some other means so as to allow the Company to earn its authorized return on equity, as required by Tenn. Code Ann. § 65-5-103(d)(6). Please see Section V below for further discussion.

IV. INTEREST RATE

Whether the provision for interest at the rate of the Overall Cost of Capital compounded for two years to be added to the Annual Reconciliation Revenue Requirement (whether positive or negative) should be modified if the Forward Looking Test Year filing requirement and associated annual rate adjustment based on the Forward Looking Test Year filing are eliminated from the Annual Review Mechanism. If any modification is recommended: (a) describe the modification in detail; (b) discuss the rationale supporting the modification; (c) detail any advantages and/or disadvantages of making the modification in relation to the Company's capability to earn its Authorized Return on Equity annually on a continuing basis; and (d) set forth with specificity and discuss in detail any related changes to the Company's tariff and/or Approved Methodologies necessary to implement the modification. If no modification is

recommended, please discuss in detail the reasons for retaining the provision for interest stated in the Annual Review Mechanism tariff.

Q. WHAT IS THE PURPOSE OF THE INTEREST RATE AS REFERENCED IN THE REQUEST AND INCLUDED IN THE PROVISIONS OF THE ARM TARIFF?

A. While the Forward Looking filing (as discussed above) works to match the timing of revenues billed and collected to total cost of service, the Annual Reconciliation filing recognizes that, despite the parties' efforts to develop forecast methodologies that are reasonable, rigorous and properly executed, some things that occur throughout the course of a year are out of the Company's control. In most of the states in which the Company operates under annual mechanisms, the Company has subscribed to the idea that those items will generally add to or subtract from actual cost of service with equal regularity and probability. In Tennessee, however, the parties in Docket No. 14-00146 agreed to an Annual Reconciliation in the Settlement Agreement in that docket. In order to best comply with the statutory requirement that the Company's rates be adjusted "to provide that the public utility earns the authorized return on equity established in the public utility's most recent general rate case," an interest rate was added to the Annual Reconciliation Revenue Requirement ("ARRR") to compensate the Company or its customers (depending on whether the ARRR was positive or negative respectively) for the lag between when actual cost of service is incurred and when the ARRR is billed to customers in rates.

Q. WAS THE INTEREST RATE IN QUESTION INTENDED TO BE A SIGNIFICANT COMPONENT OF THE COMPANY'S RATES BILLED TO CUSTOMERS?

A. No. The ARM tariff is designed so that the majority of the sufficiency or deficiency calculated each year in the Forward Looking Test Year filing is built into the rates that immediately follow the conclusion of that filing. The rates are implemented no more than 120 days following the filing and, as discussed above, align revenues to cost of service for the Forward Looking Test Year.

Q. IF THE FORWARD LOOKING FILING WERE TO BE ELIMINATED, WOULD THE INTEREST RATE COMPRISE A BIGGER COMPONENT OF THE COMPANY'S RATES BILLED TO CUSTOMERS?

A. Likely yes. The mechanics of a hypothetical mechanism that was based on an historic test year while still fulfilling the statutory requirement to earn "the authorized return on equity established in [the Company's] most recent general rate case" would rely more heavily on the interest rate used to bridge the gap between revenue collected and cost of service incurred. Currently, the bulk of each year's sufficiency or deficiency is incorporated into the forward looking rates, which are implemented in alignment with costs as they are incurred and with the interest rate applied to the ARRR only after it is calculated following the end of the Forward Looking Test Year. The Approved Methodologies were developed to forecast the Company's cost of service in a manner that in most years should minimize the ARRR and therefore minimize the amount of interest that is applied. If the forward looking treatment designed into the ARM tariff were eliminated, the interest applied in some form would make up a much more significant piece as it would become (in some form or fashion) the primary instrument used to eliminate regulatory lag. As discussed above, the elimination of regulatory lag is necessary for the Company to earn its authorized return on equity and therefore required by the alternative regulation statute.

Q. WOULD THE PROVISION FOR INTEREST AT THE RATE OF THE OVERALL COST OF CAPITAL COMPOUNDED FOR TWO YEARS TO BE ADDED TO THE ANNUAL RECONCILIATION REVENUE REQUIREMENT (WHETHER POSITIVE OR NEGATIVE) NEED TO BE MODIFIED IF THE FORWARD LOOKING TEST YEAR FILING REQUIREMENT AND ASSOCIATED ANNUAL RATE ADJUSTMENT BASED ON THE FORWARD LOOKING TEST YEAR FILING ARE ELIMINATED FROM THE ANNUAL REVIEW MECHANISM?

A. Likely yes. As discussed above, should the Forward Looking Test Year filing requirement and associated annual rate adjustment based on the Forward Looking Test Year filing be eliminated from the Annual Review Mechanism, there would need to be significant modifications to the mechanism in order to satisfy the statutory requirement that the Company earn its Authorized Return on Equity on an ongoing annual basis. The potential solution would very likely involve an interest rate component in some form or fashion. Because the appropriate way to derive any interest calculation would necessarily depend on the types of modifications made to the ARM, the Company cannot propose an appropriate calculation at this time. As discussed below, the Company is willing to pursue such a solution should the Commission desire.

V. OTHER MODIFICATIONS

Whether any other modification(s) to the Annual Review Mechanism should be made to provide that the Company earns its Authorized Return on Equity on an ongoing annual basis. For each such modification: (a) describe the proposed modification in detail; (b) discuss the rationale supporting the modification; (c) detail any advantages and/or disadvantages of making the modification in relation to the Company's capability to earn its Authorized Return on Equity annually on a continuing basis; and (d) set forth with specificity and discuss in detail any related changes to the Company's tariff and/or Approved Methodologies necessary to implement the recommended modification.

A. The Company believes that its ARM tariff, as currently written and executed, is consistent with the provision of the statute cited in the request (that the Company earns its Authorized Return on Equity). Should the Commission desire to consider modifying the Company's ARM tariff to prescribe one annual filing rather than two, the Company is open to considering such modifications. The Company believes that an appropriate solution does exist that results in an ARM tariff with one annual filing while providing for the Company to earn its authorized rate of return on equity via forward looking treatment or some alternative approach that achieves the same results. The Company, also believes, however, that finding such a solution should be attained through a collaborative effort involving all interested parties in order to be sustainable. The Company is willing, at the desire and direction of the Commission, to participate in such an effort and will commit to working diligently to finding a sustainable solution.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

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VERIFICATION

STATE OF TEXAS)

COUNTY OF DALLAS)

I, Gregory K. Waller, being first duly sworn, state that I am the Manager of Rates and Regulatory Affairs for Atmos Energy Corporation, that I am authorized to testify on behalf of Atmos Energy Corporation in the above referenced docket, that the Direct Testimony of Gregory K. Waller in support of Atmos Energy Corporation's filing in response to questions in the August 28, 2018 Order Establishing Procedural Schedule is true and correct to the best of my knowledge, information and belief.

G. Waller

Gregory K. Waller

Sworn and subscribed before me this 12th day of September, 2018.

Notary Public

My Commission Expires: 9/1/2020

GISELLE R HEROY
Notary Public, State of Texas
Comm. Expires 09-01-2020
Notary ID 13080484-2