BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION
NASHVILLE, TENNESSEE

IN RE:	)	
	)	
PIEDMONT NATURAL GAS COMPANY, INC. PETITION FOR AN ADJUSTMENT OF RATES, CHARGES, AND TARIFFS APPLICABLE TO SERVICE IN TENNESSEE	)	**Docket No. 20-00086**

CONSUMER ADVOCATE'S RESPONSES TO
PIEDMONT NATURAL GAS COMPANY'S DISCOVERY REQUESTS

Comes now the Consumer Advocate Unit in the Financial Division of the Office of the Tennessee Attorney General ("Consumer Advocate") and hereby submits its Discovery Responses to Piedmont Natural Gas Company, Inc. ("Piedmont" or "Company").

GENERAL OBJECTIONS TO DISCOVERY REQUESTS

The Consumer Advocate objects to the breadth and scope of Piedmont's discovery requests (including the Preliminary Matters and Definitions) on the grounds that some of the individual requests are overly broad, unduly burdensome, vague, ambiguous, and otherwise beyond the scope of permissible discovery under Rule 26. Further, some of the requests are objectionable because they seek the production of documents and/or information that are neither relevant to the issues/claims raised in this matter nor reasonably calculated to lead to the discovery of admissible evidence. In addition, some of the requests are objectionable because they seek documents and information that are protected from disclosure under the attorney-client and work product privileges. Without waiving any of these General Objections, the Consumer Advocate will respond to the individual document production requests as set forth below.

RESPONSES

1. Please provide copies of all Data Requests from other parties in this Proceeding when they are received by the Consumer Advocate.

RESPONSE:

There are only two parties currently authorized by TPUC to participate in this Docket – Piedmont and the Consumer Advocate. At this time, the Consumer Advocate has received only Piedmont's data requests issued on December 3, 2020. If other parties are permitted to intervene by TPUC and issue data requests to the Consumer Advocate, the Consumer Advocate will supplement this Response within an appropriate amount of time.

2. Please provide copies of all the Consumer Advocate's responses to Data Requests from other parties in this Proceeding as soon as they are transmitted to the party making the request.

RESPONSE:

See response to Item No. 1-1. If the Consumer Advocate responds to data requests from any other party permitted to participate in this proceeding, the Consumer Advocate will supplement this response within an appropriate amount of time.

3. Please provide all Data Requests issued by the Consumer Advocate to other parties in this Proceeding as soon as they are submitted to the party.

RESPONSE:

At this time, the Consumer Advocate has only issued data requests to Piedmont, this Docket's only other party. If the Consumer Advocate does issue data requests to parties other than Piedmont in this proceeding, the Consumer Advocate will supplement this response within an appropriate amount of time.

While not necessarily responsive to this request, please see Attachment No. 1-3 for copies of two public records requests issued to TPUC by the Consumer Advocate.

4. Please provide all responses received by the Consumer Advocate to Data Requests issued by it to other parties as soon as the responses are received.

RESPONSE:

See response to Item No. 1-3. If the Consumer Advocate receives responses to data requests, it will provide them to Piedmont within an appropriate amount of time.

Please see Attachment No. 1-4 for TPUC's responses to the previously referenced public records requests issued to TPUC.

5. Please provide the Consumer Advocate's docket filings (including testimony and exhibits) in native format (Word, Excel (with formulae intact and working macros)). Please consider this an ongoing request, and applicable to any revised, additional, supplemental, rebuttal, etc., filings.

RESPONSE:

Please see Attachment 1-5 for the testimonies in Word version of CA Witnesses Novak, Klein, Dittemore, and Bradley. The exhibits and workpapers were previously provided in native format on November 30, 2020.

6. Please identify and provide copies of all Documents and workpapers (including all related Excel files with working formulae and links intact) supporting and/or underlying all testimony, exhibits (including initial, revised, additional, supplemental, updated, rebuttal, etc.) filed by the Consumer Advocate in this Proceeding. Please consider this request ongoing.

RESPONSE:

The workpapers and files supporting the Consumer Advocate's testimony were contained within the files previously submitted on November 30, 2020, to the Commission and Piedmont in this Docket.

7. Please provide support for the Consumer Advocate's quantification of zero lag days on federal income tax expense in the Consumer Advocate's working capital computation.

RESPONSE:

The Consumer Advocate did not have sufficient information to assess the split of income tax expense between current and deferred. Therefore, a conservative assumption was made to reflect zero lag days for the balance of Federal Income Taxes, increasing the cash working capital balance compared with alternative calculations. The reliance of an expense lag of zero applied to Federal Income Taxes increased cash working capital and thus Rate Base by approximately $900,000 compared with the results using the value of 37.50 days as used by the Company in its cash working capital calculation.

8. In reference to Witness Bradley's recommendation that 75% of STIP costs be disallowed on page 4 of his testimony, please (i) explain how he arrived at his 75% figure, and (ii) produce, in native format, with formulas active and intact, any studies, analyses, or workpapers supporting his recommendation.

RESPONSE:

(i) Mr. Bradley reviewed the materials provided in the Minimum Filing Requirements and discovery responses provided on behalf of Piedmont. Specifically, Mr. Bradley relied on the information provided in response to MFR 38 and the Confidential Attachment to DR2-209. A review of these metrics shows Short-Term Incentive

Plan's (STIP) top two weighted metrics relate to the Parent's financial performance and growth, specifically, tying at-risk pay to Earnings Per Share.

(ii) See Mr. Bradley's AB-1 Incentive Compensation Expensed.xlsx and AB-2 Incentive Compensation Capitalized.xlsx provided with the Consumer Advocate's testimony on November 30, 2020.

9. In reference to Witness Bradley's recommendation that 75% of LTIP costs be disallowed on page 5 of his testimony, please (i) explain how he arrived at his 75% figure, and (ii) produce, in native format, with formulas active and intact, any studies, analyses, or workpapers supporting his recommendation.

RESPONSE:

(i) Mr. Bradley reviewed the materials provided in the Minimum Filing Requirements and discovery responses provided on behalf of Piedmont. Specifically, Mr. Bradley reviewed the response to MFR 46 and the discovery responses submitted on behalf of the Company. A review of the materials provided shows that a majority of the performance goals of the Long-Term Incentive Plan (LTIP) are designed to promote the financial market performance of the Parent.

(ii) See Mr. Bradley's AB-1 Incentive Compensation Expensed.xlsx and AB-2 Incentive Compensation Capitalized.xlsx provided with the Consumer Advocate's testimony on November 30, 2020.

10. In reference to Witness Bradley's assertion on page 6 of his testimony that his proposed incentive compensation adjustments are consistent with prior Commission findings, please identify and produce a copy of each Order or other Commission finding or precedent he relied upon in making such an assertion.

RESPONSE:

The Consumer Advocate's analysis of at-risk compensation as included in an incentive plan involves an examination of who benefits from the goals of such a plan: (1) ratepayers; (2) shareholders; or (3) both.[1] After determination of who benefits from the incentive plan, a decision can be made on who should bear such costs. In such examinations in the past, the Commission has determined that the cost of certain incentive plans should be disallowed completely[2] or the costs borne by shareholders and ratepayers[3].

11. In reference to Witness Bradley's proposed increased disallowance for lobbying expense on page 7 of his testimony; please (i) explain the basis for his conclusion that 75% of the subjects duties are lobbying/governmental relations related, and (ii) produce, in native format, with formulas active and intact, any studies, analyses, or workpapers supporting such conclusion.

RESPONSE:

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[1] *Direct Testimony of John Hughes*, *In re: Petition of Chattanooga Gas Company for a General Rate Increase, Implementation of the EnergySMART Conservation Programs and Implementation of a Revenue Decoupling Mechanism*, TRA Docket No. 09-00183 (March 10, 2010); *Direct Testimony of Terry Buckner*, *In re: Petition of Atmos Energy Corporation for Adjustment of Rates*, TRA Docket No. 12-00064 (October 4, 2012); and *Direct Testimony of David Dittemore*, *In re: Petition of Chattanooga Gas Company for Approval of an Adjustment in Rates and Tariff; the Termination of the AUA Mechanism and the Related Tariff Changes and Revenue Deficiency Recovery; and an Annual Rate Review Mechanism*, TPUC Docket No. 18-00017 (July 3, 2018).

[2] *Order*, *In re: Petition of Chattanooga Gas Company for a General Rate Increase, Implementation of the EnergySMART Conservation Programs and Implementation of a Revenue Decoupling Mechanism*, TRA Docket No. 09-00183 (November 8, 2010) and *Order Approving Settlement*, *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)*, TRA Docket No. 14-00146 (November 4, 2015).

[3] *Order, In re: Application of Nashville Gas Company, a Division of Piedmont Natural Gas Company, Inc for an Adjustment of its Rates and Charges*, TRA 96-00977 (February 19, 1997) (A copy of this order was provided in Piedmont's Response to DR 1-86); *Order*, *In re: Petition of Chattanooga Gas Company for a General Rate Increase, Implementation of the EnergySMART Conservation Programs and Implementation of a Revenue Decoupling Mechanism*, TRA Docket No. 09-00183 (November 8, 2010); and *Amended Order, In re: Petition of Chattanooga Gas Company for Approval of an Adjustment in Rates and Tariff; the Termination of the AUA Mechanism and the Related Tariff Changes and Revenue Deficiency Recovery; and an Annual Rate Review Mechanism*, TPUC Docket No. 18-00017 (January 15, 2019).

(i) Mr. Bradley reviewed the materials provided in the Minimum Filing Requirements and discovery responses provided on behalf of Piedmont. Specifically, Mr. Bradley reviewed the Discovery Responses provided within DRs 1-60 and 2-39. In Mr. Bradley's review of the Confidential job summary provided in response to DR 1-60, a majority of the employee's work relates to governmental relations related to tasks and managing the lobbying efforts of the Company. The disallowance of expenses related to lobbying when setting rate "is a well-established and long-standing policy of the [Commission]."[4]

(ii) See Mr. Bradley's AB-3 Lobbying Expense CONFID.xlsx provided with the Consumer Advocate's testimony on November 30, 2020.

12. In reference to the discussion of prepaid taxes on page 49 of Witness Novak's testimony; please explain how the Consumer Advocate has treated the prepaid taxes (inspection fee and GRT) in its proposed revenue decrease. If not included, please explain why this item does not need to be included in the revenue requirement in this general rate case.

RESPONSE:

For clarity, Mr. Novak's discussion of prepaid taxes on page 49 of his testimony is related only to the exclusion of those prepaid taxes from the revenue conversion factor calculation. The inclusion of the attrition period amount for the Tennessee Gross Receipts Tax is discussed on page 46 of Mr. Novak's testimony. The inclusion of the attrition period amount for the TPUC Inspection

[4] *Final Order, In re: Petition of Tennessee American Water Company for a General Rate Increase*, p. 62, TRA Docket 10-00189 (April 27, 2012). The TRA explained that "expenses related to lobbying are expended for the benefit of the Company first and foremost, and are not necessary for the provision of safe and adequate service." *Id.* The Tennessee Public Service Commission explained that the disallowance of lobbying expenses is due to its belief that "the first obligation of the company's lobbyist is to act in a manner that is beneficial to the company, which may or may not be beneficial to the company's customers." *Order, In re: South Central Bell Telephone Company*, TPSC Docket No. U-6493 (December 30, 1977).

Fee is embedded within the Consumer Advocate's forecast of Administrative & General Expense (Account 928014).

Although the TPUC Inspection Fee and the Tennessee Gross Receipts Tax are categorized as "prepaid taxes" by the Company, they are both based on historical receipts. For example, both taxes for the attrition period will be based on the receipts for the twelve months ended December 31, 2020. Therefore, the impact from any change in rates recognized by the TPUC in this rate case will have no impact on the attrition period expense for these taxes. Further, Mr. Novak is not aware of any previous rate case (including previous rate cases for Piedmont) where these prepaid taxes have been recognized as components within the revenue conversion factor.

13. Please identify and provide copies of any evidence in the possession of the Consumer Advocate indicating that ROEs were lowered in general rate case orders issued by the TPUC as a result of a regulated utility's stated intent to seek an Annual Rate Mechanism. Also provide all evidence supporting ROE reductions ordered by the TPUC in conjunction with the approval of an Annual Rate Mechanism.

RESPONSE:

The Consumer Advocate objects to this discovery request to the extent it asks the Consumer Advocate to produce documents that fall under the protection of the attorney work product doctrine. Specifically, documents, including but not limited to Court or Commission orders, are protected work product as they are gathered during the course of legal research and case preparation and otherwise relate to the thoughts and legal strategies of the Consumer Advocate's attorneys.

Notwithstanding the foregoing objection, please refer to the Consumer Advocate's pre-filed direct testimony in this matter. Consumer Advocate Witnesses Mr. Dittemore and Dr. Klein advocate for the establishment of a lower ROE in the event that Piedmont receives TPUC approval of an ARM. Please also refer to the video[5] of the legislative session cited in the Consumer Advocate's pre-filed direct testimony, which is publicly available, concerning the Tennessee General Assembly's discussion of the merits of creating statutory mechanisms for alternative regulation and the TPUC Order[6] referenced in Item No. 1-10 that discusses such a measure.

Additionally, please refer to Tenn. Code Ann. § 65-5-103(d)(6)(C), which states:

> Pursuant to the procedures set forth in subdivision (d)(1), the commission shall review the annual filing by the public utility within one hundred twenty (120) days of receipt and order the public utility to make the adjustments to its tariff rates to provide that the public utility earns the authorized return on equity established in the public utility's most recent general rate case pursuant to § 65-5-101 and subsection (a).

Therefore, based upon a plain reading of the statute, a company's most recent general rate case is the appropriate matter to set an approved ROE percentage. While other portions of a mechanism may change during the course of future ARM dockets before TPUC, if the Commission is going to consider what ROE to set in the event a company achieves an ARM, it must do so at the time of that rate case.

14. In reference to question 13 on page 11 of Witness Novak's testimony in this docket, please provide the normalization calculations for the industrial tariffs for the last six (6) years.

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[5] House Commerce Committee at Time 39:11 – 39:15, HB1349 (May 5, 2009) (the video is publicly available at http://tnga.granicus.com/MediaPlayer.php?view_id=77&clip_id=1406). Specifically, Chairman Eddie Roberson stated that the "lower the risk of the Company, which I believe, we've had testimony before this at the Authority, will reduce the rates of the Company anywhere from 25-50 basis points." *Id.*

[6] *Order*, *In re: Petition of Chattanooga Gas Company for a General Rate Increase, Implementation of the EnergySMART Conservation Programs and Implementation of a Revenue Decoupling Mechanism*, TRA Docket No. 09-00183 (November 8, 2010).

RESPONSE:

Refer to the "WHN Revenue Workpapers-FINAL" spreadsheet that was provided to the Commission and the Company along with the Consumer Advocate's testimony on November 30, 2020. Within this spreadsheet, refer to the following workpapers that provide the weather normalization calculations for each customer class for the last six (6) years.

Customer Class	**Weather Normalization Workpapers**
Residential (Rate 301)	R-10-3.00 to R-10-3.12
Small General Service (Rate 302)	R-15-3.00 to R-15-3.12
Medium General Service (Rate 352)	R-20-3.00 to R-20-3.12
Large Firm General Service (Rate 303)	R-25-3.00 to R-25-3.12
Large Interruptible General Service (Rate 304)	R-30-3.00 to R-30-3.12
Large Firm Transport Service (Rate 313)	R-35-3.00 to R-35-3.12
Large Interruptible Transport Service (Rate 314)	R-40-3.00 to R-40-3.12
Sale for Resale Service (Rate 310)	R-45-3.00 to R-45-3.12
Special Contract (Rate 373)	R-50-3.00 to R-50-3.12

15. In reference to Witness Novak's reliance on historical financial results of Piedmont prior to the 12-month test period ended March 31, 2020 on page 5 of his testimony, please provide copies of any legal or administrative precedent or academic discussions supporting such approach, which Witness Novak relied upon in adopting such an approach.

RESPONSE:

To Mr. Novak's recollection, the Tennessee Public Utility Commission has traditionally considered data prior to the test period within rate case dockets in order to ensure that the test period data is free of any anomalies that may be unique to a select twelve month period. An easily available precedent for this statement can be found in Mr. Novak's testimony from previous Piedmont rate cases that are listed on page 2 of his direct testimony.

16. In reference to Witness Novak's calculation of attrition period billing determinants on pages 8 and 9 of his testimony, please provide, in native format with formulas active and intact, any studies, analyses, or workpapers supporting the conclusion that Piedmont's attrition period billing determinants for industrial tariffs should be normalized for weather.

RESPONSE:

Refer to the Consumer Advocate's response to Item No. 14.

17. In reference to Witness Novak's assertion that Piedmont's minimum margin agreements are unlawful gas surcharge agreements, please identify and provide copies of all Commission rulings, rules, statutes, or other legal or administrative precedent relied upon by Witness Novak in arriving at such conclusion.

RESPONSE:

Tennessee Code Ann. § 65-5-101 grants the Tennessee Public Utility Commission the power to fix rates of the public utilities under its jurisdiction. Further, TPUC Rule 1220-04-01-.05 requires public utilities to present any changes in rates to the Commission for approval. Given that the Company's minimum margin agreements did not exist in the last rate case (TRA Docket No. 11-00144) and the Company has not made any filing with the Commission for approval of these agreements, then they would rightfully be considered as unlawful gas surcharges.

In TPUC Docket No. 19-00072, Atmos Energy Corporation recognized that "the provisions regarding minimum margin requirements [were] not specially authorized by the Company's existing Tennessee tariffs. As a result, Atmos filed its *Petition* to obtain TPUC approval of the

Agreement."[7] Atmos Energy Corporation sought the Commission approval pursuant to TPUC Rule 1220-04-01-.07, which states:

> Special contracts between public utilities and certain customers prescribing and providing rates, services and practices not covered by or permitted in the general tariffs, schedules or rules filed by such utilities are subject to supervision, regulation, and control by the Commission. A copy of such special agreements shall be filed, subject to review and approval.

After a hearing, the Commission "concluded that departure from application of tariff rates is justified under the specific circumstances wherein a non-tariffed rate could be applied."[8] The Commission's approval, therefore, was necessary in order for the utility to depart from the prior approved tariff. Unlike Atmos in that case, Piedmont has never filed for such approval.

18. In reference to Witness Novak's assertions regarding rate design on pages 51-53 of his testimony, please identify and provide, in native format, with formulas active and intact, any studies, analyses, or workpapers supporting his recommendations.

RESPONSE:

Refer to the "Attachment WHN-7" spreadsheet that was provided to the Commission and the Company along with the Consumer Advocate's testimony on November 30, 2020.

19. In reference to Witness Klein's assertion on pages 18-19 of his testimony that adoption of an ARM will reduce Piedmont's business risk in a way that reduces its cost of equity, please identify each and every Document, publication, study, analysis, statute, administrative regulation, or ruling known to the Consumer Advocate or Witness Klein supporting such conclusion.

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[7] *Order Approving Agreement*, *In re: Petition of Atmos Energy Corporation for Approval of Agreement with Brown-Forman Corporation, d/b/a Jack Daniel Distillery*, p. 2, TPUC Docket No. 19-00072 (January 22, 2020).
[8] *Id.* at p. 8

RESPONSE:

The Consumer Advocate objects to this discovery request to the extent it asks the Consumer Advocate to produce documents that fall under the protection of the attorney work product doctrine. Specifically, documents, including but not limited to Court or Commission orders, are protected as work product as they are gathered during the course of legal research and case preparation and otherwise relate to the thoughts and legal strategies of the Consumer Advocate's attorneys.

Notwithstanding the foregoing objection, in addition to the statement by Chairman Robeson cited in Mr. Dittemore's testimony (pages 6-7), the Authority, in TRA Docket No. 09-00183, adopted a 25 basis point reduction in return on equity (page 45) under the decoupling proposal (or AUA, Alignment and Usage Adjustment). [9] Since the AUA only adjusted for variations in revenues and an ARM also adjusts for costs, the implied reduction in ROE under an ARM is greater than 25 basis points.

20. In reference to Witness Klein's recommendation on pages 20 and 21 of his testimony that the Commission reduce the ROE established in this docket prospectively in the event an ARM mechanism for Piedmont is ultimately established, please identify each and every Document, publication, study, analysis, statute, administrative regulation, or ruling upon which such recommendation is based.

RESPONSE:

[9] *Order*, *In re: Petition of Chattanooga Gas Company for a General Rate Increase, Implementation of the EnergySMART Conservation Programs and Implementation of a Revenue Decoupling Mechanism*, TRA Docket No. 09-00183 (November 8, 2010).

The Consumer Advocate objects to this discovery request to the extent it asks the Consumer Advocate to produce documents that fall under the protection of the attorney work product doctrine. Specifically, documents, including but not limited to Court or Commission orders, are protected as work product as they are gathered during the course of legal research and case preparation and otherwise relate to the thoughts and legal strategies of the Consumer Advocate's attorneys.

Notwithstanding the foregoing objection, please refer to the Consumer Advocate's response to Item No. 1-19.

21. In reference to Witness Klein's recommendation on page 21 of his testimony that the Commission establish a 50 basis point reduction in ROE for Piedmont if an ARM is adopted, please identify each and every Document, publication, study, analysis, statute, administrative regulation, or ruling upon which such recommendation is based.

RESPONSE:

The Consumer Advocate objects to this discovery request to the extent it asks the Consumer Advocate to produce documents that fall under the protection of the attorney work product doctrine. Specifically, documents, including but not limited to Court or Commission orders, are protected as work product as they are gathered during the course of legal research and case preparation and otherwise relate to the thoughts and legal strategies of the Consumer Advocate's attorneys.

Notwithstanding the foregoing objection, please see the response to Item No. 1-19.

22. Please provide any and all workpapers, in native format and with all formulas active and intact, used by Witness Klein for the preparation of his testimony in

the proceeding.

RESPONSE:

See Attachment 1-22.

23. With regard to Witness Dittemore's recommendation on page 7 of his testimony that the Commission should authorize a ROE at the lower end of the range to factor in Piedmont's intent to request an ARM, please identify each and every Document, publication, study, analysis, statute, administrative regulation, or ruling upon which such recommendation is based.

RESPONSE:

The Consumer Advocate objects to this discovery request to the extent it asks the Consumer Advocate to produce documents that fall under the protection of the attorney work product doctrine. Specifically, documents, including but not limited to Court or Commission orders, are as work product as they are gathered during the course of legal research and case preparation and otherwise relate to the thoughts and legal strategies of the Consumer Advocate's attorneys.

Notwithstanding the foregoing objection, the recommendation referenced in testimony is supported by the response to request 2-38 as well as the video referenced within footnote 14 of Mr. Dittemore's testimony. Further, the recommendation is consistent with the Commission's findings in TRA Docket No. 09-00183 in which the Commission found a 25-basis point reduction in return on equity associated with the company's decoupling proposal was appropriate.[10] No

[10] *Order*, *In re: Petition of Chattanooga Gas Company for a General Rate Increase, Implementation of the EnergySMART Conservation Programs and Implementation of a Revenue Decoupling Mechanism*, TRA Docket No. 09-00183 (November 8, 2010).

further specific document, publication, study, analysis, administrative regulation or relying was relied upon in preparing testimony.

24. Please explain the rationale for including both of the following A&G expense adjustments into the Consumer Advocate's proposed revenue requirement adjustment computation, as these two A&G expense adjustments appear to be partially duplicative:

WHN Expense Workpapers-Final A&G Analysis-1 Excel cell H24: ($3,057,594) WHN Expense Workpapers-Final A&G Analysis-1 Excel cell H38: ($4,024,982)

RESPONSE:

An error exists in the Consumer Advocate's case from a duplicative adjustment for deferred pension funding amortization. The impact for the correction of this error would be an increase in Administrative & General Expense of $2,756,999 ($2,686,344 + $70,655) as shown on WHN Expense Workpaper RB-65-1.00.

Second, the Pension adjustment found in Workpaper DND Exp 7 should be corrected to calculate the adjustment based upon the difference between the Consumer Advocate's attrition period ad Piedmont's test period balance. The initial adjustment was computed based upon the difference between the Consumer Advocate's attrition period balance and the Company's proposed attrition period balance. The impact of this correction is to increase the Consumer Advocate's attrition period Administrative and General Expense $1,267,984 as shown on Workpaper DND Exp 7.

25. Please explain how, if at all, the information and calculations shown in the

following tabs within the file "WHN Rate Base Workpapers-FINAL.xlsx", were ultimately used for the computation of the Consumer Advocate's proposed revenue requirement adjustment. The tab names are as follows:

DEBS Normal Adds
DEBS Historical Additions-1
DEBS Historical Additions-2
DEBS Normal Rets
DEBS Historical Retirements – 1
DEBS Historical Retirements – 2
DEBS Historical Balance – 1
DEBS Historical Balance – 2
DEBS Historical Plant Data

RESPONSE:

The identified spreadsheet tabs all refer to the plant activity and plant balances of Duke Energy Business Services (DEBS). The analysis contained on these spreadsheet tabs was removed in the Mr. Novak's final rate base calculation and as a result, are not considered in the Consumer Advocate's proposed revenue requirement adjustment.

RESPECTFULLY SUBMITTED,



DANIEL P. WHITAKER III (BPR No. 035410)
Assistant Attorney General
KAREN H. STACHOWSKI (BPR No. 019607)
Assistant Attorney General
Office of the Tennessee Attorney General
Consumer Advocate Unit, Financial Division
P.O. Box 20207
Nashville, Tennessee 37202-0207
(615) 532-9299
Email: Daniel.Whitaker@ag.tn.gov
Karen.Stachowski@ag.tn.gov

CERTIFICATE OF SERVICE

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

Paul S. Davison, Esq.
Waller Landsden Dortch & Davis, LLP
511 Union Street, Suite 2700
Nashville, TN 37219
paul.davidson@wallerlaw.com

James H. Jeffries IV, Esq.
McGuire Woods LLP
201 North Tryon Street, Suite 3000
Charlotte, NC 28202
jjeffries@mcguirewoods.com

Brian S. Heslin, Esq.
Deputy General Counsel
Duke Energy Corporation
550 S. Tryon Street
Charlotte, NC 28202
brian.heslin@duke-energy.com

This the 11th day of December, 2020.



DANIEL P. WHITAKER III
Assistant Attorney General

Consumer Advocate

Attachment 1-3

Table of Contents

Document Title
20-00086 CA Records Request to Piedmont
20-00086 TPUC Records Request re HomeServe

STATE OF TENNESSEE

Office of the Attorney General

HERBERT H. SLATERY III
ATTORNEY GENERAL AND REPORTER
P.O. BOX 20207, NASHVILLE, TN 37202
TELEPHONE (615)741-3491
FACSIMILE (615)741-2009

October 6, 2020

Kelly Cashman-Grams
General Counsel
c/o Tory Lawless
Docket Manager
Tennessee Public Utility Commission
502 Deaderick Street
Nashville, TN 37243

Re: Records Request Related to Piedmont, Natural Gas Company, Inc.

Dear Ms. Cashman-Grams:

Pursuant to Tenn. Code Ann. § 65-4-118(b)(2), the Consumer Advocate Unit in the Financial Division of the Tennessee Attorney General's Office (Consumer Advocate) respectfully requests the Tennessee Public Utility Commission (TPUC) to furnish a specific record which the Consumer Advocate believes the TPUC may possess that are needed for the Consumer Advocate's analysis in TPUC Docket No. 20-00086. The record requested is as follows:

1. TPUC Docket No. 11-00144. Piedmont Natural Gas Company's (Piedmont) Additional Responses to the Commission Staff Data Request. Piedmont filed its response on October 21, 2011. The Consumer Advocate is requesting an unredacted copy of Piedmont's Response to DR 1-10. As a Party to TPUC Docket No. 11-00144, the Consumer Advocate affirms it is still subject to the Protective Order issued in TPUC Docket No. 11-00144 that was issued by the Commission on September 27, 2011. Commission Staff's DR 1-10 reads as follows:

   10. Does Piedmont receive any royalties from HomeServe related to the sale or provision of Interior Gas Line Coverage in Tennessee (royalties related to the befit derived from the use of Piedmont's name, vice-president's signature, logo, reputation, goodwill and corporate image, etc.)? If so, please provide the amount received for the twelve months

ending May 31, 2011. Please provide detailed justification if n royalties were assessed or received.

Thank you for your time and consideration of this matter. If you have questions regarding this request, please contact me at (615)741-2370.

Respectfully,

Karen H. Stachowski

Karen H. Stachowski
Assistant Attorney General

cc: Paul S. Davidson, Esq.
James H. Jeffries, IV, Esq.

STATE OF TENNESSEE

Office of the Attorney General

HERBERT H. SLATERY III
ATTORNEY GENERAL AND REPORTER
P.O. BOX 20207, NASHVILLE, TN 37202
TELEPHONE (615)741-3491
FACSIMILE (615)741-2009

October 13, 2020

Kelly Cashman-Grams
General Counsel
c/o Tory Lawless
Docket Manager
Tennessee Public Utility Commission
502 Deaderick Street
Nashville, TN 37243

Re: Records Request Related to HomeServe USA

Dear Ms. Cashman-Grams:

Pursuant to Tenn. Code Ann. § 65-4-118(b)(2), the Consumer Advocate Unit in the Financial Division of the Tennessee Attorney General's Office (Consumer Advocate) respectfully requests the Tennessee Public Utility Commission (TPUC) to furnish a specific record which the Consumer Advocate believes the TPUC may possess that is needed for the Consumer Advocate's analysis in TPUC Docket No. 20-00086. The record request is as follows:

1. Pursuant to TPUC Rule 1220-04-11-.04, "telephone solicitors engaging in the solicitation of Tennessee residential telephone subscribers" are required to register with the Commission. The Consumer Advocates requests a copy (with appropriate redactions) of HomeServe USA's[1] *Telephone Solicitor Registration Application* filed with the Commission. If the Commission determines that it cannot provide a redacted copy of the application, the Consumer Advocate requests confirmation that such an application was filed and the date it was filed.

Thank you for your time and consideration of this matter. If you have questions regarding this request, please contact me at (615)741-2370 or at karen.stachowski@ag.tn.gov.

Respectfully,

Karen H. Stachowski

Karen H. Stachowski
Assistant Attorney General

cc: Paul S. Davidson, Esq.
James H. Jeffries, IV, Esq.
TPUC Docket No. 20-00086

[1] This request includes any filings under different names such as HomeServe USA Corp, HomeServe PLC, HomeServe USA Repair Management Corp., or HomeServe Insurance Agency Corp.

Consumer Advocate

Attachment 1-4

Table of Contents

Document Title
Docket No. 20-00086 Response to K.Stachowski (10-14-2020)
Docket No. 20-00086 Response to K.Stachowski (Request dated 10-6-2020) (10-16-2020)

TENNESSEE PUBLIC UTILITY COMMISSION

Kelly Cashman-Grams
General Counsel
(615) 770-6856

Andrew Jackson State Office Bldg.
502 Deaderick Street, 4th Floor
Nashville, TN 37243-0001

October 14, 2020

Via Email to karen.stachowski@ag.tn.gov

Ms. Karen Stachowski
Assistant Attorney General
Office of Tennessee Attorney General and Reporter
Financial Division, Consumer Advocate Unit
P.O. Box 20207
Nashville, Tennessee 37202

RE: Response to Request for Records under Tenn. Code Ann. § 65-4-118
Docket No. 20-00086, *In re Petition of Piedmont Natural Gas Company, Inc. for Approval of an Adjustment of Rates, Charges, and Tariffs Applicable to Service in Tennessee*

Dear Ms. Stachowski:

As requested in your letter of October 13, 2020, I have attached the *Telephone Solicitor Registration Application* submitted to the Commission by HomeServe USA Corp. for the period of July 1, 2020 through June 30, 2021. No additional applications were located under any of the alternative entity names listed in the footnote to your letter. This document is produced in accordance with Tenn. Code Ann. § 65-4-118 and should not be construed as an acknowledgment that such records are subject to the Tennessee Public Records Act.

A copy of this letter is being sent to opposing counsels of record below in Docket No. 20-00086. The Consumer Advocate should, upon request, provide a copy of the responses to any counsel or party in this docket. Should you have any questions concerning this information, please do not hesitate to contact me.

FOR THE TENNESSEE PUBLIC UTILITY COMMISSION:

Kelly Cashman Grams

Kelly Cashman Grams, General Counsel

cc: TPUC Docket No. 20-00086
Paul Davidson at *Paul.Davidson@wallerlaw.com*
James H. Jeffries IV at *JJeffries@mcguirewoods.com*

DocuSign Envelope ID: 6B614F30-8194-4FE3-95C6-07C2BA156901

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FISCAL OFFICE
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CK# 029254 SOURCE RA20
20570 AMT 500.00

Tennessee Public Utility Commission
502 Deaderick Street, 4th Floor
Nashville, TN 37243

Telephone Solicitor Registration Application

Application is hereby made to obtain access to the Tennessee "Do-Not-Call Register" pursuant to TPUC Rule 1220-4-11-.04. Registration submitted for **July 1, 2020 – June 30, 2021.** Please print or type the information requested below.

Federal Taxpayer ID [redacted] **Check one: New Registration** ☐ **Re-registering** ☒

Legal Name of Corporation,

HomeServe, Service Line Warranties of America — HomeServe, Service Line Warranties of America

Business or Individual Name used when contacting the public. Trade name(s), assumed name(s) or fictitious names used.

Nature of Business service contracts, protection plans, and service plans

This registration is for: ☒ Standard Registration ☐ Principal Solicitor **(mark one with X)**

E-mail Address for Delivery of the DNC List:

Contact Person for Inquiries from the TPUC: This is the only person authorized to make changes to your company information and is responsible for keeping all application information correct and **updated.** Mailing address for contact must be within US borders; phone numbers must be US area codes or toll free numbers.

Phone # [redacted] Fax # 203-919-1250 E-mail Address [redacted]

601 Merritt 7, 6th Floor — Norwalk — CT — 06851

Contact — State

Person authorized to respond to notices of alleged violations from TPUC:

Phone # 203-541-8722 Fax # 203-919-1250 E-mail Address scott.paris@homeserveusa.com

601

Is applicant utilizing ADADs or predictive dialers for calls originating or terminating in Tennessee? Yes X

Provide the telephone number(s) for responding to inquiries relative to the telephone solicitation during hours when telephone solicitations are being made. Toll Free (203) 351 - 4912

Provide name, address and telephone number of Telemarketer(s) if your telemarketing is being outsourced:

Provide the contact information of the Registered Agent for Service of Process. (They must be located in Tennessee.)

CT — TN

State — #

On a separate sheet of paper marked as Supplemental Attachment, list the name, address and telephone number of all subsidiaries and affiliate companies associated with your company which will have access to your Do-Not-Call Register. An affiliate company is one that your company effectively controls because of its ownership interest. A subsidiary company is one in which your company owns more than 50% of the voting shares. see attached Exhibit B

FEE: **PLEASE OBTAIN A TRACKING NUMBER FROM YOUR MAIL DELIVERY SERVICE WHEN SUBMITTING FEES**

1. If you marked standard registration, mail the completed original application including a check for $500.00 to: Tennessee Public Utility Commission, Attn: Jimmie Hughes, 502 Deaderick Street, 4th Floor, Nashville, TN 37243.

2. If you marked Principal Solicitor, mail the completed original application including a check in the amount of $1,000.00 and an additional $50.00 for each independent solicitor listed on the Supplemental Attachment 2 to: Tennessee Public Utility Commission, Attn: Jimmie Hughes, 502 Deaderick Street, 4th Floor, Nashville, TN 37243.

Compliance Statement

The Tennessee "Do-Not-Call Register" telephone solicitor applicant, hereby, affirms the following:

I/We will comply with the Tennessee Public Utility Commission's ("TPUC") Rules and Regulations Chapter 1220-4-11 and all other applicable state laws, including but not limited to T.C.A. Section 65-4-401, *et seq*.

I/We will notify the Tennessee Public Utility Commission within thirty (30) days of any material change relative to this application or the information contained therein.

Having been duly sworn, and under the penalties of perjury, I hereby certify that the representations in the APPLICATION and all attachments are true and correct to the best of my knowledge and belief.

DocuSigned by:
Lynn Gefen
F942E4C111CA4A2...
SIGNATURE

HomeServe USA Corp.
NAME OF APPLICANT - COMPANY NAME

Lynn Gefen
PRINTED NAME

Deputy General Counsel & Chief Compliance Officer
TITLE

Subscribed and sworn to or affirmed before me, this 10th **day of** June, 2020.
Day Month Year

Known to be the person named in, and who executed the foregoing application.

My commission expires on 1/31/2023.

Signature of Notary and Authorized Official

Alejandro Pagani
Notary Public-Connecticut
My Commission Expires
January 31, 2023

Seal

Additional information on the Do-Not-Call Program, including a copy of the Program's Rules and Regulations, can be obtained from www.tn.gov/tpuc. All questions regarding the information on this application should be referred to Jimmie Hughes at (615) 741-2904.

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SECURED

Certificate Of Completion

Envelope Id: 6B614F3081944FE395C607C2BA156901
Subject: Please DocuSign: TN Jun20 Telemarketing Renewal.pdf
Source Envelope:
Document Pages: 2
Certificate Pages: 1
AutoNav: Enabled
EnvelopeId Stamping: Enabled
Time Zone: (UTC-05:00) Eastern Time (US & Canada)

Signatures: 1
Initials: 0

Status: Completed

Envelope Originator:
Alejandro Pagani
601 Merritt 7
6th Floor
Norwalk, CT 06851
alejandro.pagani@homeserveusa.com
IP Address: 66.175.103.200

Record Tracking

Status: Original
6/10/2020 8:39:14 AM

Holder: Alejandro Pagani
alejandro.pagani@homeserveusa.com

Location: DocuSign

Signer Events	Signature	Timestamp
Lynn Gefen Lynn.Gefen@homeserveusa.com HomeServe USA Security Level: Email, Account Authentication (None)	DocuSigned by: Lynn Gefen F9E2E4C111CA4A2...	Sent: 6/10/2020 8:40:26 AM Viewed: 6/10/2020 9:09:16 AM Signed: 6/10/2020 9:09:47 AM
	Signature Adoption: Pre-selected Style Using IP Address: 66.175.103.200	

Electronic Record and Signature Disclosure:
Not Offered via DocuSign

In Person Signer Events	Signature	Timestamp

Editor Delivery Events	Status	Timestamp

Agent Delivery Events	Status	Timestamp

Intermediary Delivery Events	Status	Timestamp

Certified Delivery Events	Status	Timestamp

Carbon Copy Events	Status	Timestamp

Witness Events	Signature	Timestamp

Notary Events	Signature	Timestamp

Envelope Summary Events	Status	Timestamps
Envelope Sent	Hashed/Encrypted	6/10/2020 8:40:26 AM
Certified Delivered	Security Checked	6/10/2020 9:09:16 AM
Signing Complete	Security Checked	6/10/2020 9:09:47 AM
Completed	Security Checked	6/10/2020 9:09:47 AM

Payment Events	Status	Timestamps

HomeServe USA Corp. – Tennessee Telephone Solicitor Registration Renewal
Exhibit A – Outsourced Telemarketing Vendors

- **Dial America:**
  - Inbound Services:
    - Address: 960 Macarthur Boulevard, Mahwah, NJ 07495
    - Contact: Account Manager: Dan Connolly
    - Phone: (201) 258-8252
  - Outbound Services:
    - Address: 960 Macarthur Boulevard, Mahwah, NJ 07495
    - Contact: Account Manager: Andrew Habermas
    - Phone: (201) 258-8252
- **PCCW:**
  - Inbound Services:
    - Address: 5200 Ring Road, Dublin, OH 43017
    - Contact Person: Liz Wright
    - Phone: (319) 383-1116

EXHIBIT B – AFFILIATES WITH DNC REGISTER ACCESS

Affiliate:

- HomeServe USA Repair Management Corp.:
  - Address: 7134 Lee Highway Chattanooga, TN 37421
  - Contact Phone Number: 423-499-7801
- Columbia Service Partners, Inc.:
  - Address: 4000 Town Center Boulevard, Ste.400, Canonsburg, PA 15317
  - Contact Phone Number: 423-499-7830

CompliancePoint®

4400 River Green Parkway
Suite 100
Duluth, GA 30096
(800) 585-4888 toll-free
www.compliancepoint.com

June 18, 2020

Tennessee Public Utility Commission
502 Deaderick St. – 4th Floor
Nashville, TN 37243

Attn: Jimmie Hughes

Enclosed is the Telephonic Solicitor registration renewal and check for the fee on behalf of HomeServe USA Corp.

Please let us know if anything else is required.

Kind regards,

Kathy Pelland, Coordinator
Telemarketer Registration Support Service
678-287-7773 Direct Line
678-828-4377 eFax
kpelland@compliancepoint.com

Enc

TENNESSEE PUBLIC UTILITY COMMISSION

Kelly Cashman-Grams
General Counsel
(615) 770-6856

Andrew Jackson State Office Bldg.
502 Deaderick Street, 4th Floor
Nashville, TN 37243-0001

October 16, 2020

Via Email to Karen.Stachowski@ag.tn.gov

Ms. Karen Stachowski
Assistant Attorney General
Office of Tennessee Attorney General and Reporter
Financial Division, Consumer Advocate Unit
P.O. Box 20207
Nashville, Tennessee 37202

RE: Response to Request for Records under Tenn. Code Ann. § 65-4-118
Docket No. 20-00086, *In re Petition of Piedmont Natural Gas Company, Inc. for Approval of an Adjustment of Rates, Charges, and Tariffs Applicable to Service in Tennessee*

Dear Ms. Stachowski:

I am in receipt of your letter of October 6, 2020, which requests an *unredacted* copy of Piedmont Gas Company's Response to Data Request 1-10 filed on October 21, 2011 in Docket No. 11-00144.

Unfortunately, the Commission is unable to produce the record that you have requested. It appears that the official hard copy docket file was disposed of according to the Commission's then-applicable 6-year Record Disposition Authorization (RDA).[1] As such, the agency no longer possesses a hard copy record in Docket No. 11-00144, and has available only the originally scanned public version electronic file. In addition, Commission personnel also conducted, without success, a search of various paper and electronic work files related to Docket No. 11-00144. My apologies that we are unable to be of assistance.

A copy of this letter is being sent to opposing counsels of record below in Docket No. 20-00086. Should you have any questions concerning this response, please do not hesitate to contact me.

FOR THE TENNESSEE PUBLIC UTILITY COMMISSION:

Kelly Cashman Grams, General Counsel

cc: TPUC Docket No. 20-00086
Paul Davidson at *Paul.Davidson@wallerlaw.com*
James H. Jeffries IV at *JJeffries@mcguirewoods.com*

[1] In 2018, the agency amended its Record Disposition Authorization so that it now retains official docket filings permanently.

Consumer Advocate

Attachment 1-5

Table of Contents

*These are not attached, as they were requested in their 'native' format (Word Documents). You should receive via email the following documents:

Document Title
20-00086 Klein Direct Testimony Final
KleinExhibit20-00086Final
20-00086 PUBLIC Testimony of Alex Bradley
Dittemore Final Public
Piedmont-20-00086 - WHN Testimony

Consumer Advocate

Attachment 1-10

Table of Contents

Document Title	Reference
09-00183 Hughes Direct Testimony	Footnote 1
12-00064 CAPD PUBLIC Testimony of Terry Buckner 10-5-12	Footnote 1
TPUC 18-00017 Dave Dittemore Direct Testimony	Footnote 1
09-00183 CGC Order 11-8-10	Footnote 2
14-00146 Order approving Settlement 2015 11 04 – (*Stipulation & Settlement agreement attached with order)	Footnote 2
18-00017 Amended Order	Footnote 3

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2010 MAR 10 PM 4:54
T.R.A. DOCKET ROOM

Before the

TENNESSEE REGULATORY AUTHORITY

IN RE:	)	
	)	
PETITION OF CHATTANOOGA GAS COMPANY FOR APPROVAL OF ITS RATES AND CHARGES, MODIFICATION OF ITS RATE DESIGN, AND REVISED TARIFF	)	**DOCKET NO. 09-00183**

AFFIDAVIT

I, John Hughes, Regulatory Analyst, for the Consumer Advocate and Protection Division of the Attorney General's Office, hereby certify that the attached Direct Testimony represents my opinion in the above-referenced case and the opinion of the Consumer Advocate Division.

JOHN HUGHES

Sworn to and subscribed before me
this 10th day of March, 2010.

NOTARY PUBLIC

EMILY KNIGHT
STATE OF TENNESSEE NOTARY PUBLIC
DAVIDSON COUNTY, TENN.
My Commission Expires AUG. 23, 2011

My commission expires: Aug. 23, 2011

Before the

TENNESSEE REGULATORY AUTHORITY

IN RE:	)	
	)	
PETITION OF CHATTANOOGA GAS	)	
COMPANY FOR APPROVAL OF ITS	)	
RATES AND CHARGES, MODIFICATION	)	**DOCKET NO. 09-00183**
OF ITS RATE DESIGN, AND REVISED	)	
TARIFF	)	

****

DIRECT TESTIMONY
OF
JOHN HUGHES

****

March 10, 2010

INTRODUCTION

Q. Please state your name for the record.

A. My name is John Hughes.

Q. By whom are you employed and what is your position?

A. I am employed by the Consumer Advocate and Protection Division ("Consumer Advocate") in the Office of the Attorney General for the State of Tennessee ("Office") as a Financial Regulatory Analyst.

Q. How long have you been employed in conjunction with the financial accounting industry?

A. Before my current employment with the Office, I was employed in all phases of Public Accounting. I have practiced in Tennessee and Florida for seventeen years. I have performed duties as a Staff Accountant, Auditor, Audit Manager, Accounting Manager, Financial Planner and Analyst, Corporate Controller and Tax Consultant. My most in depth area of concentration over my career is corporate audits and taxation.

Q. What is your educational background and what degrees do you hold?

A. I have a Bachelors Degree in Business Administration from the University of Pittsburgh, Pennsylvania, with a major in Accounting. I also have a Master of Business Administration Degree in Finance from Dowling College, Oakdale, New York. I am also a Tennessee Certified Public Accountant, and a Florida Certified Public Accountant. Further, I hold a license as a Certified Financial Planner, valid in all 50 states.

Q. Would you briefly describe your responsibilities as a Regulatory Analyst with the Consumer Advocate?

A. I review tariffs and prepare testimony and financial exhibits in rate proceedings as an employee with the Consumer Advocate.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to address five issues with the forecasted financial exhibits prepared by Chattanooga Gas Company ("CGC") for the attrition year ended April 30, 2011. The five issues I wish to discuss are: (1) Incentive Plans, which are the Annual Incentive Plan ("AIP"), the Long-Term Incentive Plan ("LTIP"), and the Officer Incentive plan ("OIP"); (2) Payroll Expenses (3) Bad Debt Expenses; (4) Administrative and General Expenses; and (5) Taxes, Other Than Income.

For the sake of brevity, I will only address those areas where significant, material differences exist between the Consumer Advocate and CGC. The remaining differences are small, non-material differences resulting mostly from the use of differing test years and the use of differing growth and inflation factors.

OPERATION AND MAINTENANCE EXPENSES:

Q. Explain the issue of Incentive Plans

A. CGC has included $556,071[1] of incentive plan compensation in its results of Operations for the year ended April, 30. 2011. Simply put, Incentive Plans are financial awards to certain officers and employees of

[1] CGC response FG #51

CGC and its parent company, AGL Resources, Inc. In large part, the financial awards are based on the earnings of the company. CGC has disclosed three separate Incentive Plans: (1) AIP; (2) LTIP; and (3) OIP.

The AIP Plan

The AIP plan resulted in the company compensating employees by $488,007[2] during the year ended December 31, 2009. The AIP plan is based on three (3) performance components: Corporate Performance, Business Unit Performance, and Individual Performance. Corporate Performance is based solely on earnings per share goals. Business Unit Performance is based on specific goals with respect to the financial performance of their individual business unit. Individual Performance has two measures, 'what you achieve' and 'how you achieve'.[3] CGC will include approximately $421,071[4] in compensation for employees for the AIP plan during the attrition year, based on payroll growth.

In Tennessee Regulatory Authority ("TRA" or "Authority") Docket No. 96-00977[5], the TRA allowed 50% of certain incentive plan costs to be charged to ratepayers and 50% to be charged to stockholders. In reaching their decision, the TRA held that both the Nashville Gas stockholders and the ratepayers benefited from increased performance and efficiencies from individual employees and the cost should be borne by both parties accordingly.[6] Based on this precedent, the cost of any Incentive Plan that does not benefit the ratepayers should be borne entirely by the shareholders.

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[2] Consumer Advocate DR 54-1
[3] TRA Docket 06-00175, 11/20/2006
[4] CGC response FG # 51
[5] *In Re Nashville Gas Company,* 175 P.U.R. 4th 347 (February 19, 1997).
[6] *Id.*

The current AIP plan serves the interests of both ratepayers and stockholders. Therefore, relying on the past precedent set in Docket No. 96-00977, the Consumer Advocate urges the TRA to allow only 50% of AIP compensation to be charged to ratepayers. This amount would calculate to be $210,536 for the attrition period year ending April 30, 2011.

The LTIP and OIP Plans

The LTIP plan, for which the company compensated employees $135,000[7] during the year ended April 30, 2011, is based on up to twenty-three different financial performance measures, all of which are **"based solely on earnings per share goals".**[8]

Based on the above cited amount for the year ended December 31, 2009, the attrition year amount would grow to be approximately $138,000, based on payroll growth from customer growth increases and inflation.

Because there is no mechanism under the LTIP for CGC's ratepayers to share in these increased earnings, CGC's employees and stockholders will reap *all* of the financial rewards of these higher earnings.

As cited above in TRA Docket No. 96-00977, because the current LTIP rewards only employees and stockholders, all LTIP costs should be disallowed. Therefore, the Consumer Advocate, based on past precedent, urges the disallowance of all of the proposed LTIP compensation.

The OIP is "the granting of stock options and the awarding of restricted stock."[9] The granting of the 'award' is determined by the Compensation Committee of the Board of Directors of the Company:

[7] Consumer Advocate DR 54-1
[8] TRA Docket 06-00175, 11/20/2006
[9] TRA Docket 06-00175, 11/20/2006

> In making Officer Incentive Plan award decisions, the Compensation Committee may take into account the nature of services to be rendered by the Eligible Employee, the Eligible Employee's potential contribution to the Company's success and such other factors as the Committee, in its sole discretion, may deem relevant.[10]

Since ratepayers are the sole source of CGC's regulated earnings, both the LTIP and OIP plans are circular ones whose success is built into this docket. Basically, CGC has proposed rewarding their employees and stockholders for merely increasing natural gas rates charged to ratepayers. Of note, utility incentive plans have been recently limited or disallowed in Louisiana, Kentucky, Idaho, Connecticut, Illinois and Oklahoma.[11]

Specifically, In *Entergy Louisiana, Inc., Ex Parte*, 2005 WL 372935 (May 25, 2005), the Commission disallowed the recovery of Entergy's Long Term Incentive Compensation Plan, stating that the bonuses were unrelated to any benefits to the ratepayer. The Commission reasoned that shareholders, and not customers, should bear the cost of the incentive payments because such bonuses were not directly linked to matters such as rate stability, service quality, outage reductions, and minimizing length of outages, reductions in numbers of complaints and other such rate and service-related matters.[12]

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[10]TRA Docket 06-00175, 11/20/2006

[11]*Entergy Louisiana, Inc., Ex Parte*, 2005 WL 372935 (Ma7 25, 2005); *Commonwealth Edison Co. v. Illinois Commerce Commission*, 2009 WL 3048420 (September 17, 2009); *In re Public Service Co. of Oklahoma*, 270 P.U.R. 4th 205 (January 14, 2009); *In re United Water Idaho Inc.*, 2005 WL 3091674 (September 20, 2005); and *In re Kentucky-American Water Co.*, 2005 WL 1080806 (March 30, 2005).

[12]*Entergy Louisiana, Inc., Ex Parte*, 2005 WL 372935 (Ma7 25, 2005).

The Illinois Court of Appeals also recently disallowed the portion of the incentive program that attributes benefits solely to shareholders, specifically the portion tied to "Earnings Per Share", stating, "the very term earnings per share provided a connotation of benefits for shareholders, rather than for ratepayers."[13]

Similarly, the Oklahoma Commission also disallowed the costs of long-term incentive compensation programs that result in payments based on financial goals that benefit shareholders alone.[14]

Following this trend in precedent, there is no reasonable basis to charge the cost of the LTIP and the OIP plans to ratepayers, because the benefits of the programs will accrue entirely to CGC's employees and shareholders and all of the proposed program's burden will be charged directly to ratepayers. As a result, these amounts have been excluded from the Consumer Advocate's calculations and should be borne solely by the beneficiaries of the plan, CGC's shareholders.

If CGC's employees are successful in increasing the Company's earnings, even to the point of earning above the authorized rate of return set by the TRA, CGC will reward its employees for this effort through the LTIP and the OIP. In such a case, ratepayers would not only be unreasonably burdened by the over-earnings, but under CGC's proposal, they also would have to pay an "over earnings surcharge" in the form of the LTIP and OIP. The Consumer Advocate does not object if CGC wants to reward it's employees for increasing its earnings from regulated operations; however, the cost of these rewards should be charged to those that benefit from the LTIP & the OIP — the Company's shareholders — not the ratepayers. In

[13] *Commonwealth Edison Co. v. Illinois Commerce Commission*, 2009 WL 3048420 (September 17, 2009).

essence, CGC's plan requires ratepayers to pay bonuses to the Company's employees for collecting windfall profits for the shareholders. It is not reasonable to ask ratepayers to pay the costs of such a plan. The major amount of bonuses paid in this case turns solely on the Company's profits (as opposed to service quality benchmarks, etc.).

Therefore, in accordance with the TRA's established precedent, CGC's ratepayers should not have to pay for the $135,000 LTIP and the OIP incentive plans designed to benefit only the shareholders. The Consumer Advocate urges the TRA to disallow the entire costs of both the LTIP incentive plan and the OIP incentive plan, and allow only 50% of the AIP incentive plan costs to be charged to ratepayers in this case.

However, should the TRA move toward a revenue decoupling mechanism in this docket (09-00183), the AIP plan would be even more burdensome to ratepayers from the AIP costs. The decoupling concept essentially *guarantees* a return to the company and its stockholders, thereby removing any financial benefit to ratepayers. In that case, the Consumer Advocate urges the denial of the entire AIP cost. Thereby, making the stockholders pay for the entire cost of all incentive plans.

PAYROLL EXPENSES:

Q. Please explain the difference in calculation of Payroll Expenses.

A. CGC states that the base salary and hourly payroll in the test year ended June 30, 2009 are $1,996,287.[15] The premium payroll (overtime and

[14] *In re Public Service Co. of Oklahoma*, 270 P.U.R. 4th 205 (January 14, 2009).
[15] TRA FG - 44

beeper pay) for the same period is $346,996.[16] During the attrition year, CGC states that base salary and hourly payroll is $2,054,175[17] and CGC's worksheets indicate that premium payroll will be only $279,746. Using the test period ending December 31, 2009, the Consumer Advocate calculates that the attrition year premium pay will be $364,910,[18] and the Consumer Advocate's attrition year payroll expense is $2,198,645.[19] As a result of using a differing test year, the Consumer Advocate's payroll expense is $51,169 higher than CGCs.

BAD DEBT EXPENSES:

Q. Please explain the difference in the calculation of Bad Debt Expenses.

A. CGC states that accruals for Bad Debts during the test year are $370,936[20], but the actual net write-off of Bad Debt Expense is $235,930[21], which is a 36.4% reduction from the allowance. Identifying overdue accounts in the collections process is quite different from including the bad debt allowance to be charged to the ratepayers. During the attrition year, CGC has forecasted $297,462 for the bad debt allowance.[22] However, the actual write-off amount will be closer to $189,197, based on the use of the test year percentage. This is a reduction of 36.4%, which is consistent with CGC's actual write-off during the test year.

The entire concept of using a 'test year' is to eliminate, as much as

[16] TRA FG - 44
[17] TRA FG - 44
[18] Consumer Advocate work paper E-PAY 2
[19] Consumer Advocate work paper E-PAY 2
[20] Consumer Advocate DR 64-1
[21] Consumer Advocate DR 64-1
[22] Consumer Advocate DR 64-1

possible, the use of estimates. An allowance is an estimate of future expense. In this case, we have very recent December 31, 2009 test year data, making an attrition year bad debt expense calculation much more predictable.

Therefore, the Consumer Advocate urges the TRA to reduce the amount allowed for Bad Debt Expense by 36.4%, or $108,265, to the level of CGC's actual bad debts for the test year. This amounts to a decrease in bad debt expense from $235,930 to $189,197, a $46,733 reduction from the test year to the attrition year.

ADMINISTRATIVE & GENERAL EXPENSES

Q. Please discuss your calculation of Administrative and General Expenses:

A. CGC has calculated an attrition year total for Administrative and General Expenses of $993,498[23]. The Consumer Advocate has calculated an attrition year total of $896,951[24]. This is a reduction of $96,541 from the CGC Administrative and General budget. The amount of this reduction is material even after allowing greater increases in nearly half of CGC's attrition year budgets (for Workers' Compensation Insurance, Postage, Jobbing Charges, Stores-Other, Development and Training Accounting, Association & Club Dues Comp, Meals & Entertainment, Taxes & Licenses, Uniforms, Bank Service Charges, and General Business Insurance) than CGC's attrition year budget shows.[25] This reduction is due to the use of

[23] Consumer Advocate DR 64-1
[24] Consumer Advocate work paper E-A&G
[25] Consumer Advocate work paper E-A&G

more recent, less stale, test year data ending December 31, 2009, versus the older test year data ending June 30, 2009, used by CGC.

CGC has budgeted $212,781 for Regulatory Commission Expense[26] during the attrition year, which is a **143% increase** over the amount budgeted in the test year. In all other expenses in the Administrative & General Budget, the test year data is expanded based on inflation and growth. The Consumer Advocate proposes using one-half of the rate case expense proposed by CGC, which amounts to $106,536.

In TRA Docket No. 08-00039[27], the Consumer Advocate argued that "much of the Company's costs associated with these (rate making) dockets are incurred for the protection of the shareholders' interests, while being assessed to the ratepayer."[28] The TRA panel voted to allow 50% of the rate case expense to be paid by the ratepayers, and 50% to be paid by shareholders in that docket.

The Consumer Advocate urges the TRA to follow the ruling precedent established in Docket No. 08-00039 by disallowing 50% of the Regulatory Commission Expense proposed by CGC, which represents the benefit received by CGC's shareholders. Further, the Consumer Advocate urges the TRA to base the total Regulatory Commission Expense on the Consumer Advocate's proposed $106,536 attrition year amount.

Q. Please discuss you calculation of Taxes, other than income taxes.

A. The primary difference between the Consumer Advocate and CGC is the forecast of Property Taxes. In calculating Property Taxes, the

[26] Consumer Advocate DR 64-1
[27] Petition of Tennessee American Water Company, TRA Docket # 08-00039, R. Buckner Direct, 7/18/2008
[28] TRA Docket 06-00175, 11/20/2006

Consumer Advocate used the more recent, less stale, test period data for the test year ended December 31, 2009. As a result of this more recent data, full year 2009 tax bills were available. Rather than using 2008 calendar year taxes, this newer tax data allowed the Consumer Advocate to calculate that 2009 property taxes were 0.6776% of the Gross Plant Balance on December 31, 2009.[29] Using this lower, more accurate, and more recent percentage, the Consumer Advocate was able to calculate the estimated property taxes for calendar year 2010 to be $1,296,949, based on a known 2009 year end Gross Plant Balance of $191,407,929, and estimated property taxes for calendar year 2011 to be $1,345,502, based on an estimated 2010 calendar year end Gross Plant Balance of $198,573,567.[30] By taking eight months of the 2010 tax calculation and four months of the 2011 tax calculation, the estimated attrition year property taxes are $1,313,133. Adding the leased property and stored gas inventory property taxes, the total property tax for the attrition year is $1,603,581.[31] This amount is $124,022 less than CGC's attrition year amount.[32]

As a result, the Consumer Advocate urges the Property Tax portion of Taxes, Other than Income Taxes, be lowered by $129,280 to reflect the use of more recent and more accurate test year data.

Q Please summarize your recommendations.

A. First, the Consumer Advocate recommends the inclusion of only 50% of the AIP costs and the rejection of all LTIP and OIP incentive plan costs, because the plans are designated for the benefit of shareholders, not

[29] Consumer Advocate work paper T-OTAX-1
[30] Consumer Advocate work paper T-OTAX-1
[31] Consumer Advocate work paper T-OTAX-1

ratepayers. If the Authority moves toward decoupling, then the Consumer Advocate recommends the exclusion of the entire AIP, LTIP and OIP costs.

Second, the Consumer Advocate calculates that CGC's provision for premium payroll during the attrition year needs to be increased $51,169 based on test year data.

Third, the Consumer Advocate recommends the inclusion of only the actual bad debt expenses experienced by the company and not the allowance. The entire concept of using a 'test year' is to eliminate, as much as possible, the use of estimates. An allowance is an estimate of future expense. In this case, we have very recent December 31, 2009 test year data, making an attrition year bad debt expense much more predictable.

Fourth, the Consumer Advocate recommends the Regulatory Commission Expense in the Administrative & General Budget amount be one-half of CGC's forecasted rate case costs amortized over a three year period based on TRA precedent in Docket No. 08-00039.

Fifth, the Consumer Advocate recommends the use of more recent and accurate property tax estimates and a resulting reduction in property tax estimates in the attrition year .

Q. Does this conclude your testimony?

A. Yes, it does.

[32] Consumer Advocate DR 64-1

Before the

TENNESSEE REGULATORY AUTHORITY

IN RE:	)	
	)	
PETITION OF CHATTANOOGA GAS	)	
COMPANY FOR APPROVAL OF ITS	)	
RATES AND CHARGES, MODIFICATION	)	**DOCKET NO. 09-00183**
OF ITS RATE DESIGN, AND REVISED	)	
TARIFF	)	

****

WORK PAPERS
OF
JOHN HUGHES

****

March 10, 2010

CHATTANOOGA GAS COMPANY
TRA DOCKET #09-00183
INDEX OF WORK PAPERS

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OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
OPERATING EXPENSE RECONCILATION SUMMARY
CHATTANOOGA GAS COMPANY TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

E-O&M SUM

Line #	Description	A/ (1) CGC TEST YR 12 MONTHS 06/30/09	B/ (2) 12 MONTHS 12/31/09	C/ (3) CGC ATTRITION YEAR 12 MONTHS 04/30/11	D/ (4) CAPD ATTRITION YR		(5) CGC -CAPD ATTR YR $ DIFFERENCE	(6) CGC -CAPD ATTR YR % DIFFERENCE
1	Payroll Expenses	$ 2,048,739	$ 2,120,539	$ 2,147,476	$ 2,199,963		(52,487)	-2.39%
2	Employee Benefits	788,190	738,290	1,270,641	1,201,530	ok	69,111	5.75%
3	Benefits Capitalized	(46,367)	(40,168)	(101,369)	(92,776)	ok	(8,593)	9.26%
4	Fleet Services and Facilities Expense	844,524	816,236	861,624	833,649	ok	27,975	3.36%
5	Outside Services	1,706,740	1,412,574	1,468,230	1,442,709	ok	25,521	1.77%
6	Bad Debt Expenses	335,913	370,936	297,642	189,197	ok	108,445	57.32%
7	Sales Promotion Expense	22,549	45,703	23,006	13,918	ok	9,088	65.30%
8	Customer Service and Account Expense	5,176	5,806	5,280	5,930	ok	(650)	-10.96%
9	Administrative and General Expenses	852,708	876,397	993,498	880,005	ok	113,493	12.90%
10	Admin. & Gen. Salaries & Exp. Capitalized	(33,772)	(37,860)	(34,456)	(38,668)	ok	4,212	-10.89%
11	Other Distribution and Storage Expense	495,824	545,154	574,178	625,098	ok	(50,920)	-8.15%
	AGL Services Company Allocations	4,184,368	4,908,973	4,516,810	4,743,331	ok	(226,521)	-4.78%
13	TOTAL OPERATIONS & MAINT. EXPENSE	$ 11,204,592	$ 11,762,580	$ 12,022,560	$ 12,003,886		$18,674	0.16%
14	Taxes Other Than Income Taxes							
15	Property Taxes	2,857,314		1,727,603	1,603,581	ok	124,022	7.73%
16	Gross Receipts Tax	922,124		698,074	699,928	ok	(1,854)	-0.26%
17	Franchise Tax Fees	589,980		666,172	310,947	ok	355,225	114.24%
18	TRA Inspections Fees	120,732		285,537	285,537	ok	0	0.00%
19	Payroll Taxes	177,065		206,959	173,560	ok	33,399	19.24%
20	Payroll Taxes Capitalized	(15,755)		(16,511)	$ (14,215)	ok	(2,296)	16.15%
21	Allocated Taxes Other Than Income	132,186		142,688	142,688		0	0.00%
22	Total Taxes Other Than Income Taxes	$ 4,783,646		$3,710,522	$ 3,202,026		$508,496	15.88%
14	Annual Percent Change		4.98%					
15	Cumulative Percent Change		4.98%	7.30%	7.13%			

A/ Exhibit RDH-2
B/ CGC response to Consumer Advocate DR #64-1.
C/ CGC response to Consumer Advocate DR #64-2.
D/ Consumer Advocate work papers.

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
SALARY AND WAGE PRICEOUT SUMMARY
CHATTANOOGA GAS COMPANY TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

E-PAY SUMMARY

	PAYROLL (CAPD)		D/ CGC	DIFFERENCE
SALARIED EMPLOYEES	$ 295,238	A/		
HOURLY EMPLOYEES	2,083,473	B/		
TOTAL	$ 2,378,711		$ 2,333,650	$ 45,060
CAPITALIZATION %	7.57%	C/	7.9779%	-0.4080%
CAPITALIZED PORTION	180,066		186,174	(6,109)
EXPENSED PORTION	$ 2,198,645		$ 2,147,476	$ 51,169

A/ Consumer Advocate work paper E PAY1.
B/ Consumer Advocate work paper E PAY2, Page 2 of 2.
C/ CGC response to Consumer Advocate DR#37 and DR #42.
D/ CGC MFR #25-11.

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
SALARY AND WAGE PRICEOUT - SALARY EMPLOYEES
CHATTANOOGA GAS COMPANY TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

E-PAY -1

A/ EMP #	A/ YEARLY SALARY AT 12/31/09	JAN 10	FEB 10	MAR 10	APR 10	MAY 10	JUN 10	JUL 10	AUG 10	SEP 10

CONFIDENTIAL

$285,213

A/ CGC response to Consumer Advocate DR #38-1.

E-PAY1

OCT 10	NOV 10	DEC 10	JAN 11	FEB 11	MAR 11	APR 11	ATTRITION PERIOD PAY	BASE YR DIFF DOLLARS

CONFIDENTIAL

TOTAL SALARY ATTRITION PERIOD PAY $ 295,237

0.0000%

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
SALARY AND WAGE PRICEOUT - HOURLY WAGE EMPLOYEES
CHATTANOOGA GAS COMPANY TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

E-PAY - 2

	A/ EMP #	A/ HOURLY RATE AT 12/31/09	ANNUAL HOURS	YEARLY HRLY WAGE BASE AT 12/31/09	B/ YEARLY 1.5 OVERTIME HOURS 12/31/09	CALC YEARLY 1.5 OVERTIME $ AMOUNT 12/31/09	B/ YEARLY 2.0 OVERTIME HOURS 12/31/09	CALC YEARLY 2.0 OVERTIME $ AMOUNT 12/31/09	B/ BEEPER @ REG.PAY OVERTIME HOURS 12/31/09	CALC BEEPER @ REG.PAY OVERTIME DOLLARS 12/31/09	SHIFT DIFF @$.30 /HR OVERTIME HOURS 12/31/09	CALC SHIFT DIFF @$.30 /HR OVERTIME DOLLARS 12/31/09	SHIFT DIFF @$.45 /HR OVERTIME HOURS 12/31/09	CALC SHIFT DIFF @$.45 /HR OVERTIME DOLLARS 12/31/09	CALC TOTAL 2009 PREM PAY DOLLARS
1															
2															
3															
4															
5															
6															
7															
8															
9															
10															
11															
12															
13															
14				CONFIDENTIAL											
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16															
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27															
28															
29															
30															
31															
32															
33															
34															
35															
				$1,660,206	7412.4	273405.255	71.25	$3,327	3057	$72,550	6462	$1,946	$2,967	$1,342	$352,570
			EMPLOYEES REMOVED		25.5	843			5	110	80	$24	$3	$1	$978
					7437.9	274248.255			3062	$72,660	6542	$1,970	$2,970	$1,343	$353,548

A/ CGC response to Consumer Advocate DR #35-1.
B/ CGC response to Consumer Advocate DR #36-1.

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
SALARY AND WAGE PRICEOUT - HOURLY WAGE EMPLOYEES
CHATTANOOGA GAS COMPANY TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

CALC BASE WAGES JAN 10	CALC BASE WAGES FEB 10	CALC BASE WAGES MAR 10	CALC BASE WAGES APR 10	CALC BASE WAGES MAY 10	CALC BASE WAGES JUN 10	CALC BASE WAGES JUL 10	CALC BASE WAGES AUG 10	CALC BASE WAGES SEP 10	CALC BASE WAGES OCT 10	CALC BASE WAGES NOV 10	CALC BASE WAGES DEC 10	CALC BASE WAGES JAN 11	CALC BASE WAGES FEB 11	CALC BASE WAGES MAR 11	CALC BASE WAGES APR 11

CONFIDENTIAL

A/ CGC response to Consumer Advocate DR #35-1.
B/ CGC response to Consumer Advocate DR #36-1.

A T T R I T I O N Y E A R 12 MONTH ATTR YR HRLY WAGE BASE AT 4/30/11	ATTR YR 1.5 OVERTIME DOLLARS 04/30/11	ATTR YR 2.0 OVERTIME DOLLARS 04/30/11	BEEPER @ REG.PAY OVERTIME DOLLARS 04/30/11	SHIFT DIFF @$.30 /HR OVERTIME DOLLARS 04/30/11	SHIFT DIFF @$.45 /HR OVERTIME DOLLARS 04/30/11	TOTAL ATTR YR PREM PAY DOLLARS	ATTN YR CGC PREM PAY	TOTAL ATTR YR TOTAL PAY DOLLARS	BASE YR DIFF DOLLARS
CONFIDENTIAL									
$1,718,563	$282,975	$3,443	$75,089	$2,014	$1,389	$364,910	$46,199	$2,083,473	$70,697
$295,238									
$2,013,801			TOTAL ATTRITION YEAR WAGES				$318,711	$295,237	$0
								$2,378,710	

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
EMPLOYEE BENEFITS EXPENSE SUMMARY
CHATTANOOGA GAS COMPANY TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

E-BENEFITS

ACCOUNT #	ACCOUNT DESCRIPTION	A/ DIRECT 12/31/09 AMOUNTS	B/ INFLATION FACTOR	C/ GROWTH FACTOR	ATTR YR AMOUNTS	
670530	Retirement Savings Plus Plan	84,312	1,349	450	86,111	
670500	Group Insurance Medical	410,834	6,573	2,191	419,598	
670515	HSA Employer Contributions	2,000	32	11	2,043	
670501	Health Benefits Offset	13,590	217	72	13,880	
670502	Flex Benefits Deductions	(119,687)	(1,915)	(638)	(122,240)	
670503	Other Post Retirement Benefits	167,771			103,277	E/
670505	Flex Vacation Deductions	(15,795)	(253)	(84)	(16,132)	
670590	AIP Bonus	198,454	3,175	1,058	67,679	D/
670594	Other/Sales Bonuses	(7,746)	(124)	(41)	(7,911)	
670520	Physicals	877	14	5	896	
670525	Miscellaneous Benefits	1,443	23	8	1,474	
670540	Short-Term Disability	13,817	221	74	14,112	
670450	Pensions	(11,581)	-	-	638,744	E/
	Total	738,290	9,314	3,105	1,201,530	

A/ CGC response to Consumer Advocate DR #64.
B/ Consumer Advocate work paper E-GDP, 1.6% for 16 months growth.
C/ Consumer Advocate work paper R-CUST TREND, one half of .80% annual billing growth.
D/ CGC response to FG 25-7 times 50%.
E/ CGC response to FG 25-6.

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
EMPLOYEE BENEFITS EXPENSE CAPITALIZATION SUMMARY
CHATTANOOGA GAS COMPANY TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

E-BENEFITS-CAP

ACCOUNT DESCRIPTION		A/ ATTR YR AMOUNTS	B/ CAP RATE	ATTR YR CAPITALIZATION
670530 Retirement Savings Plus Plan		86,111	7.57%	(6,519)
Insurance Benefits		313,281	7.57%	(23,715)
670503 Other Post Retirement Benefits		103,277	7.57%	(7,818)
670590 AIP Bonus		67,679	7.57%	(5,123)
Other Benefits		16,482	7.57%	(1,248)
670450 Pensions		638,744	7.57%	(48,353)
	Total	1,225,574		(92,776)

A/ CGC response to Consumer Advocate DR #64
B/ Consumer Advocate Workpaper E-PAY SUMMARY
C/ A * B

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
FLEET SERVICES AND FACILITIES EXPENSE SUMMARY
CHATTANOOGA GAS COMPANY TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

E-FLEET

ACCOUNT #	ACCOUNT DESCRIPTION	A/ DIRECT 12/31/09 AMOUNTS	B/ INFLATION FACTOR	C/ GROWTH FACTOR	ATTR YR AMOUNTS
670140	Fleet Fuel Expense	94,624	1,514	505	96,643
670147	Lease Fleet Equipment	86,352	1,382	461	88,195
670148	Operate and Maintain Fleet Eq	66,338	1,061	354	67,753
670050	Utilities	359,223	5,748	1,916	366,886
670170	Security	7,611	122	41	7,773
670551	Operate Cell Phone	24,483	392	131	25,005
670900	Facilities Rent/Lease Expenses	193,765	3,100	1,033	197,899
671021	Fleet Capitalization	(16,161)	(259)	(86)	(16,505)
	Total	816,236	13,060	4,353	833,649

A/ CGC response to Consumer Advocate DR #64.
B/ Consumer Advocate work paper E-GDP, 1.6% for 16 months growth.
C/ Consumer Advocate work paper R-CUST TREND, one half of .80% annual billing growth.

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
OUTSIDE SERVICES EXPENSE SUMMARY
CHATTANOOGA GAS COMPANY TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

E-OUTSIDE

ACCOUNT#/ DESCRIPTION	A/ DIRECT 12/31/09 AMOUNTS	B/ INFLATION FACTOR	C/ GROWTH FACTOR	ATTR YR AMOUNTS
620040 Outside Services - LNG Storage	2,950	47	16	3,013
640204 Perform 3Year Survey-Contracto	5,366	86	29	5,480
640206 Perform 5-Year Survey-Contract	88,606	1,418	473	90,496
640211 Perform Survey-Bus Dist Cont	31,990	512	171	32,673
640213 Perform Survey Trans.Pipe Cont	1,102	18	6	1,126
640215 Perform Leak Sur. Other Cont	7,902	126	42	8,071
640219 Right of Way Upkeep Contractor	47,750	764	255	48,769
640233 Locate Mains and Svcs- Cont.	399,258	6,388	2,129	407,775
640608 Activate Meter- Contractor	-	0	0	0
640704 PT Meter Change Contractor	-	0	0	0
640706 No Gas AGLC Work-Contractor	7,400	118	39	7,558
645210 Repair and Maintain Mains Cont	11,462	183	61	11,707
645211 Maintenance of Main Paving	52,842	845	282	53,969
645215 Repair Damage Mains-Contractor	422	7	2	431
645401 Maintain Reg. Stations- Cont	2,212	35	12	2,259
645502 Maint. Meter SetsandReg. ProCont	11,695	187	62	11,945
645710 Maintenance of Services-Contra	701	11	4	716
645711 Maintenance of Service Paving	13,559	217	72	13,849
650103 Meter Reading- Itron-Contracto	(0) D/	(0)	(0)	(0)
670200 Outside Svcs Employed	22,340	357	119	22,817
670201 Outside Svc. -Printing	434	7	2	444
670202 Outside Services Info Tech	71,971	1,152	384	73,506
670402 Outside Legal Services	559,518	8,952	2,984	571,455
670403 Miscellaneous Legal Services	18,961	303	101	19,366
670850 Outside Services -Facilities	54,132	866	289	55,286
Total	1,412,574	22,601	7,534	1,442,709

A/ CGC response to Consumer Advocate DR #64.
B/ Consumer Advocate work paper E-GDP, 1.6% for 16 months growth.
C/ Consumer Advocate work paper R-CUST TREND, one half of .80% annual billing growth.
D/ CGC response to Consumer Advocate DR #46-1.

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
BAD DEBT EXPENSE SUMMARY
CHATTANOOGA GAS COMPANY TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

E-BAD DEBT

ACCOUNT DESCRIPTION	(1) A/ DIRECT 12/31/09 AMOUNTS	(2) B/ DIRECT WRITE-OFF 12/31/09 AMOUNTS	(3) PERCENT DIFFERENCE DIRECT VS. WRITEOFF	(4) /C CGC ATTR YEAR 04/30/11 WRITEOFF	(5) (4) * (3) CAPD ATTR YR 04/30/11 WRITEOFF	(4) - (5) CAPD - CGC ATTR Y 04/30/11 DIFFERENCE
650700 Uncollectible Acct	352,522	235,711		266,659	169,605	97,054
650701 Uncollectible Accts - Damages	18,414	218		30,803	19,592	11,211
Total	370,936	235,929	63.60%	297,462	189,197	108,265

A/ CGC response to Consumer Advocate DR #64.
B/ CGC response to Consumer Advocate DR #61-1, Accruals less net Write-Offs.
C/ CGC response to Consumer Advocate DR#64-1

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
SALES PROMOTION EXPENSE SUMMARY
CHATTANOOGA GAS COMPANY TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

E=SALES

ACCOUNT#/ DESCRIPTION	A/ DIRECT 12/31/09 AMOUNTS		B/ INFLATION FACTOR	C/ GROWTH FACTOR	ATTR YR AMOUNTS
660001 Residential Sales Promotion	30,553		489	163	31,205
660006 Marketing- Direct Mail and Email	694	D/	11	4	709
660012 Sponsorships Events/Tradeshows	650		10	3	664
660300 Marketing Expenses - General	8,259		132	44	8,435
660400 Vendor/Agency Support	(26,529)		(424)	(141)	(27,095)
Total	13,627		218	73	13,918

A/ CGC response to Consumer Advocate DR #64.
B/ Consumer Advocate work paper E-GDP, 1.6% for 16 months growth.
C/ Consumer Advocate work paper R-CUST TREND, one half of .80% annual billing growth.
D/ CGC response to Consumer Advocate DR#46-1,DR #46-3.

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
CUSTOMER SERVICE AND ACCOUNT EXPENSE SUMMARY
CHATTANOOGA GAS COMPANY TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

E=CUST

ACCOUNT #/DESCRIPTION	A/ DIRECT 12/31/09 AMOUNTS	B/ INFLATION FACTOR	C/ GROWTH FACTOR	ATTR YR AMOUNTS
650100 Meter Reading Enscan	2,285	37	12	2,333
650101 Meter Reading- Itron	3,098	50	17	3,164
650900 Misc Customer Acct Exp	424	7	2	433
Total	5,806	93	31	5,930

A/ CGC response to Consumer Advocate DR #64.
B/ Consumer Advocate work paper E-GDP, 1.6% for 16 months growth.
C/ Consumer Advocate work paper R-CUST TREND, one half of .80% annual billing growth.

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
ADMINISTRATIVE & GENERAL EXPENSE RECONCILATION SUMMARY E-A&G
CHATTANOOGA GAS COMPANY TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

ACCOUNT#/ DESCRIPTION	A/ DIRECT 12/31/09 AMOUNTS	B/ INFLATION FACTOR	C/ GROWTH FACTOR	ATTR YR AMOUNTS	
670400 Injuries and Damages	31,267	500	167	31,934	
670401 Workers Compensation Expense	34,329	549	183	35,061	
670411 Legal Costs	60	1	0	61	
670100 Office and Administrative	11,579	185	62	11,826	
670104 Postage	262,873	4,206	1,402	268,481	
670108 Jobbing Charges In/Out	0	0	0	0	
670159 Scrap Materials	(1,053)	(17)	(6)	(1,076)	
670165 Stores -Other	3,605	58	19	3,682	
670102 Development and Training-Acctg.	2,352	38	13	2,403	
670105 Operational Training	97	2	1	99	
670106 Safety Training and Reg. Complia	4,629	74	25	4,728	
670800 Association and Club Dues-Comp	45,699	731	244	46,673	
670805 AssociationandClub Dues-Employee	5,880	94	31	6,006	
670806 General Dues and Subscriptions	78	1	0	80	
670855 Travel Expense	13,134	210	70	13,414	
670856 Meals and Entertainment	4,115	66	22	4,203	
670857 Meals and Entertainment 100 Percent	1,009	16	5	1,030	
670911 Equipment Lease	31,409	503	168	32,079	
670080 Tax and License	8,947	143	48	9,138	
670122 Civic Participation-Commun Dev	15,000	0	0	0	D/
670127 Uniforms	13,904	222	74	14,200	
670130 Bank Service Charges	86,498	1,384	461	88,344	
670300 General Business Insurance	210,006	3,360	1,120	214,487	
670700 Regulatory Commission Exp	87,486	1,400	467	106,536	E/F/
670840 Miscellaneous Expense	3,494	56	19	3,568	
670841 Fines & Penalties	0	0	0	0	
Total	876,397	13,782	4,594	$896,957	

A/ CGC response to Consumer Advocate DR #64.
B/ Consumer Advocate work paper E-GDP, 1.6% for 16 months growth.
C/ Consumer Advocate work paper R-CUST TREND, one half of .80% annual billing growth.
D/ CGC response to Consumer Advocate DR # 46
E/ CGC response to Consumer Advocate DR #79-1, one half of rate case costs.
F/ TRA Order in Docket 08-00039, Regulatory Expense, P. 24,25

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
ADMINISTRATIVE AND GENERAL CAPITALIZED EXPENSE SUMMARY
CHATTANOOGA GAS COMPANY TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

E-A&G-CAP

ACCOUNT#	DESCRIPTION	A/ DIRECT 12/31/09 AMOUNTS	B/ INLFLATION FACTOR	C/ CUST GR FACTOR	ATTR YEAR 4/30/2011 AMOUNTS
670150	Admin & General Salaries - Capitalized	(35,957)	(575)	(192)	(36,724)
670160	Admin & General Expenses - Capitalized	(1,903)	(30)	(10)	(1,944)
	Total	(37,860)	(606)	(202)	(38,668)

A/ CGC response to Consumer Advocate DR #64.
B/ Consumer Advocate work paper E-GDP, 1.6% for 16 months growth.
C/ Consumer Advocate work paper R-CUST TREND, one half of .80% annual billing growth.

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
OTHER DISTRIBUTION AND STORAGE EXPENSE SUMMARY
CHATTANOOGA GAS COMPANY TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

E-DIST

ACCOUNT#/ DESCRIPTION	A/ DIRECT 12/31/09 AMOUNTS	B/ INFLATION FACTOR	C/ GROWTH FACTOR	ATTR YR AMOUNTS	
625100 LNG Mnt-Struct/Improvements	0	0	0	68,314	D/
625300 LNG Mnt Purification Equip	4,147	66	22	4,236	
625400 LNG Maint Liquefaction Equip	117,109	1,874	625	119,608	
625500 LNG Mnt- of Vaporizing Equip	9,159	147	49	9,355	
625600 LNG Mnt- of Compressor Equip	16,464	263	88	16,815	
625900 LNG Mnt-Other Eqnip	72,701	1,163	388	74,252	
645200 Repair and Maintain Mains	53,096	850	283	54,229	
645214 Repair damage mains	4,904	78	26	5,008	
645400 Maintenance Regulator Stations	11,593	185	62	11,840	
645501 Maint. Meter Sets andReg. Pro	4,969	80	27	5,075	
645503 Repair Damage Service	726	12	4	741	
645506 Repair Meter Sets and Reg. Re	16,978	272	91	17,340	
645700 Maintenance of Services	24,655	394	131	25,181	
675100 Maintenance of Facilities	9,921	159	53	10,132	
675105 Software Maintenance	1,274	20	7	1,301	
675106 Large Computer Equip Maint	1,369	22	7	1,398	
675110 Maintenance Power Equipment	293	5	2	299	
675120 Maintenance Hand Tools	9,870	158	53	10,081	
675140 Maintenance of Office Equip	1,252	20	7	1,279	
620050 LNG Operation	121,011	1,936	645	123,593	
640300 Regulator Stations-Inspections	2,953	47	16	3,016	
640605 Turn-off Service	621	10	3	634	
640607 Activate Meter	1,815	29	10	1,854	
640609 Relocate Service (Re-Route)	19,083	305	102	19,490	
640611 RelocateService(Re-Route)-Cred	(28,464)	(455)	(152)	(29,071)	
640701 Investigate Leaks	403	6	2	412	
640703 PT Meter Change	3,277	52	17	3,347	
640749 Distribution-Mat Mgt	63,973	1,024	341	65,338	
Total	545,154	8,722	2,907	625,098	

A/ CGC response to Consumer Advocate DR #64.
B/ Consumer Advocate work paper E-GDP, 1.6% for 16 months growth.
C/ Consumer Advocate work paper R-CUST TREND, one half of .80% annual billing growth.
D/ CGC Response FG 25-10

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
AGL SERVICES COMPANY EXPENSE SUMMARY
CHATTANOOGA GAS COMPANY TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

E=AGL SER

ACCOUNT#/ DESCRIPTION	A/ DIRECT 12/31/09 AMOUNTS	B/ INFLATION FACTOR	C/ GROWTH FACTOR	ATTR YR AMOUNTS
671008 Allocated Corp Compliance	113,761	1,820	607	116,188
671412 Allocated Bus Supt Facilities	321,470	5,144	1,715	328,328
671415 Allocated Supply Chain Mgmt	24,980	400	133	25,513
671417 Allocated Employee Services	220,049	3,521	1,174	224,743
671419 Allocated Executive - Corp	109,968	1,759	586	112,314
671421 Allocated External Relations - Corp	11,402	182	61	11,645
671422 Allocated Financial Services	286,424	4,583	1,528	292,535
671424 Allocated IS&T Base Serv - Corp	288,372	4,614	1,538	294,524
671425 Allocated Internal Auditing	36,803	589	196	37,588
671426 Allocated Investor Relations	6,312	101	34	6,447
671427 Allocated Legal	210,424	3,367	1,122	214,913
671429 Allocated Other Corporate	(39,937)	(639)	(213)	(40,789)
671434 Allocated Corporate Communications	65,894	1,054	351	67,300
671003 AGLR Alloc Executive - Dist	56,258	900	300	57,458
671004 Allocated Ext Relations-Dis Op	32,155	514	171	32,841
671416 Allocated Call Center	324,720	5,196	1,732	331,647
671005 Allocated Call Ceuter Mgt	208,103	3,330	1,110	212,543
671103 Allocated Credit Collections	18,212	291	97	18,601
671018 Allocated Cust Serv Logistics	48,855	782	261	49,897
671104 Allocated Cust Serv Ovhd	52,447	839	280	53,566
671105 Allocated Emergency Response	59,864	958	319	61,141
671418 Allocated Engineering	172,455	2,759	920	176,134
671423 Allocated Gas Supply	174,838	2,797	932	178,568
671428 Allocated Marketing	65,907	1,055	352	67,313
671430 Allocated Rates & Regulatory	82,860	1,326	442	84,628
671446 Allocated Engineering - SOPS	17,750	284	95	18,128
671448 Allocated Executive - SOPS	110,787	1,773	591	113,151
671450 Allocated Ext Relations - SOPS	21,919	351	117	22,386
671451 Allocated Gas Supply - SOPS	50,273	804	268	51,346
671452 Allocated Marketing - SOPS	6,330	101	34	6,465
671403 Direct Assigned Chargeback	960,394	15,366	5,122	980,882
671400 IS&T Base Services - Corp	218,756	3,500	1,167	223,422
671401 IS&T Projects - Corp	6,886	110	37	7,033
671007 IS&T Projects AGLC CGC VNG	24,516	392	131	25,039
672520 IS&T Base Services - Dis Ops	460,946	7,375	2,458	470,780
672521 IS&T Projects Dis Ops	47,960	767	256	48,983
671024 Other Benefits Stock Awards	3,938	63	21	4,022
671013 AGSC DC Fleet Services	21,961	351	117	22,430
671032 AGSC DC Fleet Services SOPS	3,961	63	21	4,046
Total	$4,908,973	$78,544	$26,181	$5,013,698

A/ CGC response to Consumer Advocate DR #64-2.
B/ Consumer Advocate work paper E-GDP, 1.6% for 16 months growth.
C/ Consumer Advocate work paper R-CUST TREND, one half of .80% annual billing growth.

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
CGC - AGL SERVICES COMPANY ALLOCATIONS, NET OF CAPITALIZED AMOUNTS
CHATTANOOGA GAS CO. TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

E - ALLOC-2

1	TEST PERIOD AGL ALLOCATIONS	$4,908,973	A/
2	CIVIC PARTICIPATION ALLOCATIONS	(16,746)	B/
3	PROMOTIONAL ADVERTISING ALLOCATIONS	(3,880)	C/
4	CALL CENTER ALLOCATIONS	274,975	D/
5	GOODWILL ALLOCATIONS	(493)	E/
6	PROPERTY TAX ALLOCATIONS	(165,163)	F/
7	PUCHA TAX COLLECTION ALLOCATIONS	73,531	G/
8	ADJUSTED TEST PERIOD AGL ALLOCATIONS	$ 5,071,197	
9	AMOUNT CHARGED TO CGC FOR AIP EXPENSES	(488,007)	H/
10	AMOUNT CHARGED TO CGC FOR LTIP EXPENSES	(189,359)	I/
11	ADJ TEST PERIOD AGL ALLOCATIONS FOR AIP & LTIP	$ 4,393,831	
12	PLUS: INFLATION FACTOR	70,301	J/
13	PLUS: CUSTOMER GROWTH FACTOR	23,434	K/
14	ATTRITION PERIOD AGL ALLOCATIONS LESS AIP & LTIP	$ 4,487,566	
15	50% OF AIP EXPENSES RESTORED	148,036	L/
16	ATTRITION PERIOD WITH 50% AIP RESTORED	$4,635,602	

A/ CGC response to Consumer Advocate DR 64-1
B/ CGC response to Consumer Advocate DR 46-1,46-2
C/ CGC response to Consumer Advocate DR 46-1,46-3
D/ CGC response to Consumer Advocate DR 46-1,46-4
E/ CGC response to Consumer Advocate DR 46-1,46-5
F/ CGC response to Consumer Advocate DR 46-1,46-7
G/ CGC response to Consumer Advocate DR 46-1,46-8
H/ CGC response to Consumer Advocate DR 54-1
I/ CGC response to Consumer Advocate DR 54-1
J/ Consumer Advocate Workpaper E-GDP
K/ Consumer Advocate Workpaper R-Customer Trend
L/ CGC Response to FG 51-1

CHATTANOOGA GAS COMPANY
TRA DOCKET #09-00183
CGC - AGL COST ALLOCATION SUMMARY
FOR THE FISCAL YEARS ENDING DECEMBER 31, 2007, 2008, 2009

E-ALLOC-3

NAME OF ASSOCIATE COMPANY	A/ 2007 Total Amt Billed	A/ 2007 Total Amt Percentage	A/ 2008 Total Amt Billed	A/ 2008 Total Amt Percentage	A/ 2009 Total Amt Billed	A/ 2009 Total Amt Percentage	2007,08,09 3 Yr Avg Percentage	B/ CAPD Attriton Period Percentage	B/ Amounts
									0
								100.00%	0

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A/ CGC response to Consumer Advocate DR #49-1
B/ CGC response to Consumer Advocate DR# 47-1

	INFLATION	CUST GRWTH	ATTR AMT
0	-	-	0

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
OTHER TAX SUMMARY
CHATTANOOGA GAS COMPANY TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

T-OTAX0

Tax	Consumer Advocate	
Property Tax	$ 1,603,581	A/
TRA Inspection Fee	285,537	B/
FUTA Taxes	2,184	C/
FICA Taxes	182,080	C/
SUTA Taxes	3,510	C/
Payroll Taxes Capitalized	(14,214)	C/
Franchise Tax	675,947	D/
Gross Receipts Tax	699,928	E/
Allocated and Other Taxes	142,688	F/
Total	$ 3,581,242	

A/ Consumer Advocate work paper T-OTAX1.

B/ CGC FG-25-14.

C/ Consumer Advocate work paper T-OTAX4 and T-OTAX5.

D/ Consumer Advocate work paper T-OTAX6.

E/ Consumer Advocate work paper T-OTAX7.

F/ CGC FG-25-12.

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
STATE OF TENNESSEE PROPERTY TAX SUMMARY
CHATTANOOGA GAS COMPANY TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

T-OTAX1

Line #	Estimated Property Taxes			
1	December 31, 2008 Gross Plant Balance	$	182,206,706	A/
2	Property Tax Assessment on owned property - Payments made for 2009		1,234,603	B/
3	Tax as Percent of Gross Plant (Line 2/Line 1)		0.6776%	
4	Gross Plant at December 31, 2009	$	191,407,929	C/
5	Estimated Property Tax Expense on owned property - For CY 2010(Line 3 times Line 4)		1,296,949	
6	Estimated Gross Plant at December 31, 2010		198,573,567	C/
7	Estimated Property Tax Expense on owned property - For CY 2011 (Line 3 times Line 6)		1,345,502	
8	Total Utility Plant Property Taxes (Line 5 multiplied by 8/12 and Line 7 multiplied by 4/12 ot arrive at attrition period estimate)		1,313,133	
9	Leased Property		32,648	D/
10	Stored Gas Inventory		257,800	D/
11	Total	$	1,603,581	

A/ CGC Depreciation Study, Appendix A.
B/ CGC response to Consumer Advocate DR #57-1.
C/ Consumer Advocate work paper RB-PLANT1.
D/ CGC response to Consumer Advocate DR #57-2.

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
PAYROLL AX SUMMARY
CHATTANOOGA GAS COMPANY TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

T-0TAX3

	Consumer Advocate PAYROLL TAXES		CGC PAYROLL TAXES	
FICA & MEDICARE TAXES				
HOURLY EMPLOYEE	$ 159,495	A/		
SALARIED EMPLOYEES	22,586	B/		
TOTAL	$ 182,081			
CAPITALIZATION %	7.57%	C/		
CAPITALIZED PORTION	$ 13,784			
EXPENSED PORTION	$ 168,297			
FUTA TAXES				
HOURLY EMPLOYEES	1,960	A/		
SALARIED EMPLOYEES	224	B/		
TOTAL	2,184			
CAPITALIZATION %	7.57%	C/		
CAPITALIZED PORTION	$ 165			
EXPENSED PORTION	$ 2,019			
SUTA TAXES				
HOURLY EMPLOYEES	$ 3,150	A/		
SALARIED EMPLOYEES	360	B/		
TOTAL	$ 3,510			
CAPITALIZATION %	7.57%	C/		
CAPITALIZED PORTION	$ 266			
EXPENSED PORTION	$ 3,244			
TOTAL PAYROLL TAXES CAPITALIZED	14,215		16,511	D/
TOTAL PAYROLL TAXES EXPENSED	$ 173,560		$ 190,448	D/

A/ CAPD WORK PAPER T-OTAX4
B/ CAPD WORK PAPER T-OTAX5
C/ CAPD WORK PAPER E-PAY DIST
D/ EXHIBIT RDH-2, SCH 2

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
HOURLY PAYROLL TAX SUMMARY
CHATTANOOGA GAS COMPANY TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

T-OTAX4

* $106,000 WAGE BASE
** NO WAGE BASE

EMP #	ATTRITION PERIOD PAY	FICA * 6.20%	MEDICARE ** 1.45%	A/ $7,000 WAGE BASE FUTA *** 0.80%	B/ $9000 WAGE BASE SUTA *** 0.4%+0.6%	TOTAL PAYROLL TAXES
Total	**$ 2,084,898.95**	**$ 129,263.73**	**$ 30,231.03**	**$ 1,960.00**	**$ 3,150.00**	**$ 164,604.77**

CONFIDENTIAL

A/ Employers Federal Annual Unemployment (FUTA) Tax Return - Wage Base = $7000, rate of .008
B/ Tennessee State Unemployment Tax (SUTA) Return - Wage Base =$9000, Rate = .004 + .006 surcharge (Effective July 1, 2009)

Capitalized Labor Rate **7.57%**

Total Payroll Tax Expense (Net of Capitalized Payroll Taxes) **152,144.38**

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
SALARY PAYROLL TAX SUMMARY
CHATTANOOGA GAS COMPANY TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

T-OTAX5

* $106,000 WAGE BASE
** NO WAGE BASE
***$9000 WAGE BASE

EMP #	A/ ATTRITION PERIOD PAY	FICA * 6.20%	MEDICARE ** 1.45%	FUTA *** 0.80%	SUTA *** 1.00%	TOTAL PAYROLL TAXES
02971	$ 78,236.64	4,850.67	1,134.43	56.00	90.00	6,131.10
11819	70,382.95	4,363.74	1,020.55	56.00	90.00	5,530.30
15795	71,168.63	4,412.46	1,031.95	56.00	90.00	5,590.40
21683	75,450.01	4,677.90	1,094.03	56.00	90.00	5,917.93
	$ 295,238.24	$ 18,304.77	$ 4,280.95	$ 224.00	$ 360.00	$ 23,169.73

Capitalized Labor Rate 7.57%

Total Payroll Tax Expense 21,415.80

A/ CAPD WORKPAPER E-PAY-2.

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
SALARY PAYROLL TAX SUMMARY
CHATTANOOGA GAS COMPANY TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

T-OTAX5

* $106,000 WAGE BASE
** NO WAGE BASE
***$9000 WAGE BASE

EMP #	A/ ATTRITION PERIOD PAY	FICA * 6.20%	MEDICARE ** 1.45%	FUTA *** 0.80%	SUTA *** 1.00%	TOTAL PAYROLL TAXES
			CONFIDENTIAL			
	$295,238	$18,305	$4,281	$224	$360	$23,170
Capitalized Labor Rate						7.57%
Total Payroll Tax Expense						$21,416

A/ CAPD WORKPAPER E-PAY-2.

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
STATE OF TENNESSEE FRANCHISE TAX SUMMARY
CHATTANOOGA GAS COMPANY TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

T-OTAX6

	AMOUNT	
UTILITY PLANT IN SERVICE AT DECEMBER 31, 2009	$ 191,456,158	A/
ACCUMULATED DEPRECIATION AT DECEMBER 31, 2009	(90,680,314)	B/
NET PLANT AT DECEMBER 31, 2009	$ 100,775,844	
MATERIALS AND SUPPLIES AT DECEMBER 31, 2009	18,056,028	C/
CONSTRUCTION WORK IN PROGRESS AT DECEMBER 31, 2009	(615,013)	D/
RENT VALUE AT DECEMBER 31, 2009	1,643,267	E/
TAX RATE OF $.25 PER $100 OF NET PLANT AND M&S	$ 0.25	
FRANCHISE TAX AMOUNT FOR 2009	$ 299,650	
UTILITY PLANT IN SERVICE AT DECEMBER 31, 2010	$ 198,621,796	A/
ACCUMULATED DEPRECIATION AT DECEMBER 31, 2010	(94,592,270)	B/
NET PLANT AT DECEMBER 31, 2010	$ 104,029,526	
MATERIALS AND SUPPLIES AT DECEMBER 31, 2010	19,410,827	C/
CONSTRUCTION WORK IN PROGRESS AT DECEMBER 31, 2010	(615,013)	D/
RENT VALUE AT DECEMBER 31, 2010	1,679,428	E/
TAX RATE OF $.25 PER $100 OF NET PLANT AND M&S	$ 0.25	
FRANCHISE TAX AMOUNT FOR 2010	$ 311,262	
UTILITY PLANT IN SERVICE AT APRIL 30, 2011	$ 199,367,418	F/
ACCUMULATED DEPRECIATION AT APRIL 30, 2011	(95,715,623)	G/
NET PLANT AT DECEMBER 31, 2011	$ 103,651,795	
MATERIALS AND SUPPLIES AT APRIL 30, 2011	19,410,827	H/
CONSTRUCTION WORK IN PROGRESS AT APRIL 30, 2011	(615,013)	I/
RENT VALUE AT APRIL 30, 2011	1,679,428	J/
TAX RATE OF $.25 PER $100 OF NET PLANT AND M&S	$ 0.25	
FRANCHISE TAX AMOUNT FOR 2011	$ 310,318	
ATTRITION PERIOD FRANCHISE TAX	$ 310,947	

A/ Consumer Advocate work paper RB-PLANT1.
B/ Consumer Advocate work paper RB-ACC DEP.
C/ Consumer Advocate work paper RB-M&S, RB-GAS.
D/ Consumer Advocate work paper RB-CWIP.
E/ Consumer Advocate work paper E-FLEET, ACCT #670900 times 8 plus ACCT #670911 times 3.
F/ Consumer Advocate work paper RB-PLANT1 at April 30, 2011 as proxy.
G/ Consumer Advocate work paper RB-ACC DEP at April 30, 2011 as proxy.
H/ Consumer Advocate work paper RB-M&S, RB-GAS at December 31, 2010 as proxy.
I/ Consumer Advocate work paper RB-CWIP at December 31, 2009 as proxy.
J/ Consumer Advocate work paper E-FLEET, ACCT #670900 times 8 plus ACCT #670911 times 3 attrition year as proxy.

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
STATE OF TENNESSEE GROSS RECEIPTS TAX SUMMARY
CHATTANOOGA GAS COMPANY TRA DOCKET #09-00183
FOR THE ATTRITION YEAR ENDED APRIL 2011

T-OTAX7

	Actual Return	B/ Forecast
Gross Receipts	$ 96,179,296 A/	$ 83,342,978
Taxable Receipts	96,179,296	83,342,978
Tax Rate	1.50%	1.50%
Taxes	1,442,689	1,250,145
Less:Franchise Tax	(296,007) A/	(299,650) C/
Excise Tax	(207,849) A/	(298,347) B/
Net Tax	$ 938,833	$ 652,147
Tax 5/1/10-6/30/10	$ 156,472	
Tax 7/1/10-4/30/11		$ 543,456
Total Tax	$ 699,928	

A/ CGC response to Consumer Advocate DR #55.
B/ CGC response FG #25-15a.
C/ Consumer Advocate work paper T-OTAX6.

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
ANALYSIS OF THE GROSS DOMESTIC PRODUCT ("GDP") CHAINED PRICE DEFLATOR
FOR THE TWELVE MONTHS ENDED DECEMBER 31, 2009
CHATTANOOGA GAS TRA DOCKET #09-00183

E-GDP

	QUARTER				
YEAR	1/1 - 3/31	4/1 - 6/30	7/1 - 9/30	10/1 - 12/31	GDP IDP
2007	105.310	106.008	106.447	107.069	106.209
2008	107.534	108.069	109.172	109.172	108.487
2009	109.691	109.686	109.783	109.946	109.777
2010					

AVERAGE GDP DEFLATOR GROWTH FOR YEAR 2008 **2.15%**

AVERAGE GDP DEFLATOR GROWTH FOR YEAR 2009 **1.19%**

Source: U.S. Department of Commerce, Table 1.1.9 - Price Deflator Indexes for GDP, 2005=100

Before the

TENNESSEE REGULATORY AUTHORITY

IN RE:	)	
	)	
PETITION OF CHATTANOOGA GAS	)	
COMPANY FOR APPROVAL OF ITS	)	
RATES AND CHARGES, MODIFICATION	)	**DOCKET NO. 09-00183**
OF ITS RATE DESIGN, AND REVISED	)	
TARIFF	)	

****

EXHIBITS
OF
JOHN HUGHES

****

March 10, 2010

Bureau of Economic Analysis
National Income and Product Accounts Table

Table 1.1.9. Implicit Price Deflators for Gross Domestic Product

[Index numbers, 2005=100] Seasonally adjusted
Today is: 2/4/2010 Last Revised on January 29, 2010 Next Release Date February 26, 2010

Line		2007 I	2007 II	2007 III	2007 IV
1	**Gross domestic product**	**105.310**	**106.008**	**106.447**	**107.069**
2	**Personal consumption expenditures**	**104.245**	**105.069**	**105.677**	**107.002**
3	Goods	101.611	102.543	102.620	104.360
4	Durable goods	97.405	97.061	96.381	96.033
5	Nondurable goods	104.008	105.673	106.180	109.118
6	Services	105.663	106.429	107.325	108.426
7	**Gross private domestic investment**	**106.309**	**106.467**	**106.710**	**107.037**
8	Fixed investment	106.383	106.590	106.802	107.098
9	Nonresidential	105.670	106.090	106.346	106.695
10	Structures	119.626	120.725	121.735	122.770
11	Equipment and software	100.606	100.762	100.712	100.777
12	Residential	107.641	107.323	107.447	107.652
13	Change in private inventories	—	—	—	—
14	**Net exports of goods and services**	—	—	—	—
15	Exports	105.318	106.470	107.344	109.089
16	Goods	105.334	106.421	107.197	108.949
17	Services	105.289	106.587	107.676	109.401
18	Imports	104.722	106.342	107.938	113.072
19	Goods	104.662	106.237	107.810	113.498
20	Services	105.022	106.874	108.597	110.887
21	**Government consumption expenditures and gross investment**	**107.880**	**109.118**	**109.841**	**111.325**
22	Federal	106.800	107.726	107.884	108.564
23	National defense	107.078	108.157	108.478	109.374
24	Nondefense	106.244	106.854	106.672	106.902
25	State and local	108.520	109.942	111.002	112.969
	Addendum:				
26	Gross national product	105.311	106.007	106.444	107.070

Bureau of Economic Analysis
National Income and Product Accounts Table

Table 1.1.9. Implicit Price Deflators for Gross Domestic Product

[Index numbers, 2005=100] Seasonally adjusted
Today is: 2/4/2010 Last Revised on January 29, 2010 Next Release Date February 26, 2010

Line		2008 I	2008 II	2008 III	2008 IV
1	**Gross domestic product**	**107.534**	**108.069**	**109.172**	**109.172**
2	**Personal consumption expenditures**	**107.974**	**109.023**	**110.276**	**108.858**
3	Goods	105.675	106.662	108.434	103.767
4	Durable goods	96.026	95.814	95.514	94.718
5	Nondurable goods	111.175	112.828	115.748	108.961
6	Services	109.213	110.297	111.276	111.543
7	**Gross private domestic investment**	**106.333**	**106.815**	**107.637**	**108.850**
8	Fixed investment	106.918	107.225	107.885	108.238
9	Nonresidential	106.633	107.187	108.348	109.536
10	Structures	122.957	123.793	125.815	128.243
11	Equipment and software	100.609	101.046	101.830	102.450
12	Residential	107.209	106.755	105.710	103.097
13	Change in private inventories	—	—	—	—
14	**Net exports of goods and services**	—	—	—	—
15	Exports	111.100	113.833	115.580	108.816
16	Goods	111.126	114.337	115.907	107.720
17	Services	111.032	112.678	114.820	111.235
18	Imports	117.190	122.999	125.116	112.647
19	Goods	118.052	124.124	126.238	112.473
20	Services	112.794	117.284	119.426	113.252
21	**Government consumption expenditures and gross investment**	**113.029**	**114.765**	**115.957**	**114.229**
22	Federal	110.067	111.258	111.778	110.623
23	National defense	110.844	112.392	113.050	111.327
24	Nondefense	108.464	108.917	109.145	109.193
25	State and local	114.799	116.875	118.492	116.395
	Addendum:				
26	Gross national product	107.538	108.076	109.181	109.167

Bureau of Economic Analysis
National Income and Product Accounts Table

Table 1.1.9. Implicit Price Deflators for Gross Domestic Product

[Index numbers, 2005=100] Seasonally adjusted
Today is: 2/4/2010 Last Revised on January 29, 2010 Next Release Date February 26, 2010

Line		2009 I	2009 II	2009 III	2009 IV
1	**Gross domestic product**	**109.691**	**109.686**	**109.783**	**109.946**
2	**Personal consumption expenditures**	**108.453**	**108.818**	**109.514**	**110.238**
3	Goods	102.169	102.847	104.199	105.247
4	Durable goods	94.301	94.382	93.635	93.668
5	Nondurable goods	106.729	107.726	110.217	111.824
6	Services	111.750	111.955	112.314	112.871
7	**Gross private domestic investment**	**108.430**	**107.198**	**105.542**	**105.134**
8	Fixed investment	107.689	106.484	105.285	105.082
9	Nonresidential	109.191	108.030	106.692	106.275
10	Structures	127.097	123.711	120.456	119.791
11	Equipment and software	102.485	102.339	101.837	101.519
12	Residential	101.815	100.455	99.765	100.319
13	Change in private inventories	—	—	—	—
14	**Net exports of goods and services**	—	—	—	—
15	Exports	105.213	105.231	106.420	107.898
16	Goods	103.492	103.980	105.163	106.637
17	Services	108.925	108.011	109.214	110.704
18	Imports	103.669	104.744	107.609	111.747
19	Goods	102.293	103.667	106.860	111.348
20	Services	109.668	109.485	110.967	113.570
21	**Government consumption expenditures and gross investment**	**113.919**	**114.046**	**114.307**	**114.900**
22	Federal	111.079	111.209	111.596	112.159
23	National defense	111.576	111.657	112.188	112.907
24	Nondefense	110.080	110.315	110.397	110.631
25	State and local	115.586	115.712	115.888	116.500
	Addendum:				
26	Gross national product	109.678	109.679	109.780	—

IN THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

IN RE:	)	
	)	
PETITION OF ATMOS ENERGY	)	
CORPORATION FOR ADJUSTMENT	)	**DOCKET NO. 12-00064**
OF RATES	)	

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DIRECT TESTIMONY
OF
TERRY BUCKNER

****

October 4, 2012

IN THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

IN RE:	)	
	)	
PETITION OF ATMOS ENERGY	)	
CORPORATION FOR ADJUSTMENT	)	**DOCKET NO. 12-00064**
OF RATES	)	

AFFIDAVIT

I, Terry Buckner, Regulatory Analyst, for the Consumer Advocate Division of the Attorney General's Office, hereby certify that the attached Direct Testimony represents my opinion in the above-referenced case and the opinion of the Consumer Advocate Division.

Terry Buckner

TERRY BUCKNER

EMILY KNIGHT
STATE OF TENNESSEE NOTARY PUBLIC
DAVIDSON COUNTY, TENN.
My Commission Expires JULY 6, 2015

Sworn to and subscribed before me this 3rd day of Oct., 2012.

Emily Knight

NOTARY PUBLIC

My commission expires: July 6, 2015

Q. Please state your name, business name and address for the record.

A. My name is Robert T. ("Terry") Buckner. I am operating as a sole proprietorship, Robert T. Buckner CPA, 2783 Saundersville Ferry Road, Mount Juliet, Tennessee 37122.

Q. On whose behalf are you testifying in this docket?

A. I am submitting testimony and work papers on behalf of the Consumer Advocate and Protection Division ("Consumer Advocate") in the Office of the Attorney General for the state of Tennessee ("Office").

Q. How long have you been employed in conjunction with the public utility industry?

A. I have been employed in conjunction with the public utility industry for over thirty years. Before my retirement from the Office, I was employed by the Comptroller's Office for the state of Tennessee for nearly two years as the Assistant Director responsible for public utility audits after approximately eight years of prior employment with the Office. Formerly, I was employed with the Tennessee Public Service Commission ("Commission") in the Utility Rates Division as a financial analyst for approximately six years. My responsibilities included testifying before the Commission as to the appropriate cost of service for public utilities operating in Tennessee. Prior to my employment with the Commission, I was employed by TDS Telecom for eight years and the First Utility District of Knox County for three years.

Q. What is your educational background and what degrees do you hold?

A. I have a Bachelors degree in Business Administration from the University of Tennessee, Knoxville with a major in Accounting.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to provide my exhibit of work papers ("work papers of Terry Buckner") for forecasted Operation and Maintenance expenses and Taxes Other Than Income for Atmos Energy Company ("Company") for the attrition year ending November 30, 2013.

SUMMARY OF RESULTS

Q. Please summarize why the Consumer Advocate is projecting about $2 million less in Operation and Maintenance ("O&M") expenses than the Company.

A. The $2 million difference in O&M expenses between the Consumer Advocate and the Company is due to the Consumer Advocate's projecting: (1) $.5 million in lower Pension Expense; (2) $0.7 million less in Incentive Compensation; and (3) approximately $.8 million less in the growth rate between the end of the test period ending March 2012 to the end of the attrition year.

The Company is proposing a three year amortization of $7.7 million in ERISA contributions for Pension Expense. The $7.7 million encompasses a shortfall in their recovery of estimated ERISA contributions in TRA Docket #08-00197 through estimated ERISA contributions for the years ending

2014. Consequently, an annual amortization of $2.576 in Pension Expense is included in the Company's filing. However, the Consumer Advocate has adopted the contribution amount per their latest actuarial report, which results in about $2.1 million for the attrition year.

In addition, the Consumer Advocate rejects the Company's incentive compensation plans, which charge customers for bonuses paid to salaried employees for increasing the regulated earnings of the company, an activity that benefits the Company's shareholders by moving money to their pockets from the pockets of Company's customers. Since customers are provided no benefit from this activity, they should not have to pay any costs associated with it.

The remaining difference in the Company's and the Consumer Advocate's forecast is about $0.8 million, which is due to the growth rate from the test year to the attrition year. The Company's expense growth rate of 20.55% exceeds any economic or cost-savings justification, and has far outstripped inflation.

Q. Please summarize the Consumer Advocate's forecast of taxes other than income taxes.

A. The Consumer Advocate has calculated $6.329 million in its forecast of taxes other than income. The Company has included $6.252 million in its rate filing for taxes other than income. This results in a difference of $77,000 or 1%. Due to the small overall variance, the Consumer Advocate will not discuss its calculations of each tax or the variance within each tax.

OPERATION AND MAINTENANCE EXPENSES

Q. Please describe the components of O&M expenses.

A. The Company's filing of O&M expenses is by "Cost Element". The Consumer Advocate does not entirely forecast by Cost Element, but has forecasted and reconciled its O&M to the Company's forecast through the use of seven categories: (1) Labor; (2) Non-Labor expenses for Company 93, which is the Tennessee operations; (3) Company 91, which is the Kentucky Mid States Division office also known as the Brentwood Division; (4) Company 02, which is the Dallas corporate office; (5) Company 12, which is the Call Center Division; (6) Pension contributions or expenses; and (7) Rate Case expenses.

The Consumer Advocate calculated its labor using actual employees, labor rates at March 2012 and test period hours by employee. For new employees hired during the test year, their labor cost was priced out at 2,080 hours for the attrition year.

The Company 93 non-labor amounts per FERC account for the test period ended March 31, 2012 were grown by the annual GDP Chained Price Deflator growth rate of 2.12%.[1] The compounded growth rate from March 2012 through November 2013 is approximately 3.58%. Also, the Consumer Advocate used one half of the forecasted annual customer growth rate of .55% and compounded it through November 2013 to arrive at an additional growth rate of .46% This methodology is the standard procedure that the

[1] Terry Buckner work paper, E-GDP, Index of work papers, page 26.

Consumer Advocate uses to forecast non-salary and wage O&M Expenses in rate proceedings before the TRA.

For each of the other divisions or companies allocating costs to Tennessee operations, the Consumer Advocate eliminated FAS 87 Pension expense amounts and Incentive Compensation amounts and grew the residual amount using the same procedure applied to Company 93.

Q. Please explain the exclusion of FAS 87 Pension Expense from the Company forecast.

A. In the early 1990s, most of the pension plans of the public utilities in Tennessee were over funded.

Moreover, prior to the Company's purchase of United Cities Gas in Tennessee, the FAS 87 pension plan funding was 121%.[2] As a result, in Tennessee, only actual pension contributions have been recognized for setting rates.[3] Further, in TRA Docket #05-00258, there was "no justification for the Authority to alter its previous finding to fund only actual pension contributions."[4]

Atmos records pension expense in accordance with Financial Accounting Standard No. 87 ("FAS 87"). Tennessee's allocated portions of the FAS 87 pension expense for the attrition year were excluded for rate-setting purposes in Tennessee. This treatment of pension expense is

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[2] 1994 SEC 10-K, United Cities Gas Company, Page 38.
[3] TRA Docket #96-00977, Order dated February 19, 1997, pages 13 and 14. TRA Docket #99-0994, Order dated, July 18, 2000, pages 4-5.
[4] TRA Director Pat Miller's Motion in Docket #05-00258, Page 4.

consistent with the Consumer Advocate's forecasting methodology in prior cases and, significantly, the TRA's own precedent relating to pension costs.

Q. Please explain the difference in the forecasted amounts of Pension contributions.

A. In the Company's last rate filing, TRA Docket #08-00197, the Company and the Consumer Advocate settled on a three year rider to recover an estimated $17.5 million in pension contributions and actually agreed to extend it one more month to enable the Company to recover the total amount of the pension contribution. The use of an estimated contribution, which is not related to an independent completed actuarial report, underscores the difficulty. Now, the Company is seeking an additional $191,163 over a three year amortization from that docket. This is due to the actual contribution

The Company is proposing a three year amortization of $7.7 million in ERISA contributions for Pension Expense. The $7.7 million encompasses a shortfall in their recovery of estimated ERISA contributions in TRA Docket #08-00197 through estimated ERISA contributions for the years ending 2014. Consequently, an annual amortization of $2.576 in Pension Expense is included in the Company's filing. However, the Consumer Advocate has adopted the contribution amount per their latest actuarial report, which results in about $2.1 million for the attrition year. Moreover, rate making has been consistently prospective and the TRA recognizes that retroactive ratemaking in prohibited.

Therefore, the actuarial report by an independent source is the latest known and measureable amount for forecasting Pension Expense.

Q. What are the issues with the incentive compensation of the Company?

A. The Company has at least three incentive compensation plans: (1) Variable Pay Plan ("VPP"); (2) Management Incentive Plan ("MIP"); and (3) Long Term Incentive Plan for Management ("LTIP").[5] For purposes of simplicity, the three incentive plans will be referred to as LTIP.

On February 7, 2007, the Company conducted their annual shareholders meeting in Nashville, Tennessee.[6] Two of the items listed on the agenda were: (1) To act upon a proposal to approve an amendment to its 1998 Long-Term Incentive Plan to provide for an increase of 2,500,000 shares in the number of shares of common stock reserved for issuance under the Plan and an extension of the term of the Plan for an additional three years; and (2) To act upon a proposal to approve an amendment to its Annual Incentive Plan for Management to provide for an extension of the term of the Plan for an additional five years.[7] Specifically, the "LTIP is intended to motivate participants using performance-related incentives linked to longer-range performance goals and the interests of our shareholders."[8] Also, the Company has an Annual Incentive Plan for management. These performance goals include the following criteria: "total

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[5] Atmos Direct Testimony, J. Ellerman, Page 2, Lines 25-27.
[6] Appendix B.
[7] Appendix B, Atmos Energy Corporation, Notice of Annual Meeting of Shareholders, December 26, 2006.
[8] Appendix B, Atmos Energy Corporation, Notice of Annual Meeting of Shareholders,

shareholder return; return on assets, equity, capital or investment; earnings per share; cash flow; levels of operating expense; and measures of customer satisfaction and service." However, from the beginning of the Incentive Plan, the committee has established the performance goal each year based on the achievement of an **earnings per share** target for the fiscal year."[9] Recently, the Company met at its annual shareholder meeting in Dallas, Texas on February 8, 2012. The Proxy statement issued for the meeting state that "The EPS ("earnings per share") performance measurement is the lynchpin of both our short-term and long-term compensation plans."[10]

Again, the LTIP payroll is based on **one** sole performance measure: "Earnings Per Share."[11] Consequently, the entire incentive payroll is based on the financial operating results of the Company and all LTIP employees receive the compensation regardless of the individual employee's performance. Once more, because there is no mechanism under the LTIP for the Company's ratepayers to share in these increased earnings, the Company's employees and shareholders will reap all of the financial rewards of higher earnings. Previously, the TRA found that the same LTIP proposed by the Company in this case was of no benefit to the ratepayers[12]. This is illustrated by the following: If the Company's employees are successful in increasing the Company's earnings, even to the point of earning above the

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December 26, 2006, P. 6.

[9] Apendix B, Atmos Energy Corporation, Notice of Annual Meeting of Shareholders, December 26, 2006, P. 11.

[10] Proxy Statement dated December 22, 2011, Page 30.

[11] Atmos Direct Testimony, J. Ellerman, Page 3, Line 12; Page 4, Lines 3-4; Page 4, Lines 28-29.

[12] TRA Director Pat Miller's motion in TRA Docket #05-00258, Page 4.

authorized rate of return set by the TRA, the Company will reward its employees for this effort through the LTIP. In such a case, ratepayers would not only be unreasonably burdened by the over-earnings, but under the Company's proposal they also would have to pay an "over earnings surcharge" in the form of the LTIP. The Consumer Advocate does not object if the Company wants to reward its employees for increasing its earnings from regulated operations; however, the cost of these rewards should be charged to those that benefit from the LTIP — the company's shareholders — not the ratepayers. Therefore, in accordance with the TRA's decision in the Company's last rate case, TRA Docket #05-00258, the Consumer Advocate removed $548,519[13] in Tennessee LTIP O&M Expense from the test period ending May 31, 2007 and has a forecast amount of $0 for LTIP Expense.

Therefore, all of the costs associated with the Atmos LTIP should be excluded for setting rates.

Q. Are there any other differences in O&M Labor that you wish to discuss?

A. Yes.

Q. Please summarize the other forecast differences in O&M expense.

A. Again, the remaining difference in the Company's and the Consumer Advocate's forecast is about $0.8 million, which is due to the growth rate from the test year to the attrition year. The Company's expense growth

[13] CAPD work paper, E-LTIP, Index of Work Papers, Page 97.

rate of 20.55% exceeds any economic or cost-savings justification, and has far out-stripped inflation.

The Consumer Advocate's O&M expense forecast has about a 9% increase over the test year O&M amount ended March 31, 2012. This amount does include FAS 87 pension expense and LTIP compensation expense.

Therefore, the Consumer Advocate believes its forecast of O&M expense is a just and reasonable amount for the attrition year, especially when held in the light of the current economy.

Q. Do you have any other comments?

A. Yes. The Consumer Advocate recommends the Company provide more workpapers and supporting documentation in future rate filings to the TRA. Sufficient documentation facilitates an investigation of a public utility's rate filing and is in the best interest of all the parties. For example, the Consumer Advocate has not yet had a chance to review the responses to the TRA Data Requests dated September 18, 2012 and received October 3, 2012. Therefore, the Consumer Advocate reserves the right to revise and/or amend its filing of schedules and testimony to the TRA.

Q. Does this conclude your testimony?

A. Yes.

IN THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

IN RE:	)	
	)	
PETITION OF ATMOS ENERGY	)	
CORPORATION FOR ADJUSTMENT	)	**DOCKET NO. 12-00064**
OF RATES	)	

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WORK PAPERS
OF
TERRY BUCKNER

****

October 4, 2012

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
ATMOS EMERGY COMPANY
TRA DOCKET #12-00064
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OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
TENNESSEE - AMERICAN WATER COMPANY
TRA DOCKET #12-00049
INDEX OF WORK PAPERS – TERRY BUCKNER

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ATMOS ENERGY CORPORATION **E-REC SUMMARY**

ATMOS ENERGY CORPORATION TRA DOCKET #12-00064
O&M EXPENSE RECONCILIATION
FOR ATTRITION YEAR ENDING 11/30/13

	A/ CONSUMER ADVOCATE	B/ ATMOS	OVER (UNDER) VARIANCE
PAYROLL	$ 3,732,632	$ 3,857,085	$ (124,453)
NON LABOR COMPANY 93	5,507,160	5,404,810	102,350
COMPANY 02	1,983,275	3,099,181	(1,115,906)
COMPANY 12	1,877,209	2,002,406	(125,198)
COMPANY 91	3,515,095	3,765,014	(249,919)
PENSION EXPENSE	2,086,819	2,575,974	(489,155)
RATE CASE EXPENSE	153,333	153,333	(0)
TOTAL	$ 18,855,524	$ 20,857,804	$ (2,002,280)

A/ Consumer Advocate work papers.
B/ Atmos work papers.

ATMOS ENERGY CORPORATION
TRA DOCKET #12-00064
SALARY AND WAGE PRICEOUT - HOURLY EMPLOYEES
ATTRITION YEAR 12/01/12 - 11/30/13
CONFIDENTIAL

E-PAY-1

EMP #	RATE AT 3/31/12	RATE AT 10/1/12	RATE AT 10/1/13	ANNUAL HOURS REG	ANNUAL HOURS 1.5 X OVERTIME	OVERTIME	ATTRITION PERIOD PAY
5656	$ **13.00**	$ 13.39	$ 13.79	2,080	0		$ 27,990.46
5601	**13.00**	13.39	13.79	2,080	**12.00**	$ 241.62	28,232.68
5606	**16.01**	16.49	16.99	162	0.00	-	2,684.79
5594	**16.00**	16.48	16.97	2,080	**2.00**	49.56	34,499.48
5517	**20.68**	21.30	21.94	2,080	**57.00**	1,825.74	46,356.65
5456	**13.03**	13.42	13.82	2,080	**27.00**	544.91	28,601.31
5242	**13.12**	13.51	13.92	2,148	**5.00**	101.61	29,274.21
5213	**13.21**	13.61	14.01	2,098	**2.00**	40.92	28,729.77
5119	**16.02**	16.50	17.00	398	**3.00**	74.44	6,674.70
4966	**16.35**	16.84	17.35	369	**1.00**	25.32	6,270.60
2499	**13.56**	13.97	14.39	2,071	**56.00**	1,176.14	30,248.95
2537	**13.68**	14.09	14.51	2,302	**72.00**	1,525.57	34,127.65
2324	**16.26**	16.75	17.25	398	**3.00**	75.55	6,774.69
3141	**16.02**	16.50	17.00	345	0.00	-	5,721.17
0454	**13.85**	14.27	14.69	2,121	**48.00**	1,029.68	31,440.66
0564	**13.00**	13.39	13.79	2,080	**1.00**	20.14	28,010.64
3401	**14.03**	14.45	14.88	2,047	**76.00**	1,651.52	31,384.54
4059	**16.66**	17.16	17.67	2,240	**74.00**	1,909.50	40,544.40
0670	**14.09**	14.51	14.95	2,080	0.00	-	30,337.35
0086	**14.45**	14.88	15.33	2,216	**32.00**	716.19	33,864.73
4526	**16.68**	17.18	17.70	2,080	0.00	-	35,913.91
3561	**14.24**	14.67	15.11	2,500	**56.00**	1,235.12	38,089.55
2689	**13.00**	13.39	13.79	2,080	**3.00**	60.41	28,051.01
1542	**17.21**	17.73	18.26	2,070	**7.00**	186.59	37,063.96
1639	**14.24**	14.67	15.11	2,246	**28.00**	617.56	33,726.35
1934	**16.88**	17.39	17.91	2,287	**52.00**	1,359.53	41,324.43

ATMOS ENERGY CORPORATION
TRA DOCKET #12-00064
SALARY AND WAGE PRICEOUT - HOURLY EMPLOYEES
ATTRITION YEAR 12/01/12 - 11/30/13
CONFIDENTIAL

E-PAY-1

EMP #	RATE AT 3/31/12	RATE AT 10/1/12	RATE AT 10/1/13	ANNUAL HOURS REG	ANNUAL HOURS 1.5 X OVERTIME	OVERTIME	ATTRITION PERIOD PAY
3086	**15.11**	15.56	16.03	2,676	**6.00**	140.42	41,996.40
4841	**15.42**	15.88	16.36	2,599	**21.00**	501.55	41,988.08
3509	**16.45**	16.94	17.45	377	**12.00**	305.75	6,726.15
0370	**19.90**	20.50	21.11	398	**59.00**	1,818.52	10,021.65
4839	**18.10**	18.64	19.20	397	0.00	-	7,438.28
4575	**19.95**	20.55	21.16	398	**27.00**	834.29	9,055.57
4020	**15.30**	15.76	16.23	2,230	**31.00**	734.63	36,054.74
3210	**19.90**	20.50	21.11	398	**56.00**	1,726.05	9,928.95
3551	**19.79**	20.38	21.00	398	0.00	-	8,153.28
0511	**17.88**	18.42	18.97	2,250	**30.00**	830.81	42,476.97
2182	**17.30**	17.82	18.35	2,269	**64.00**	1,714.90	42,352.64
2785	**15.40**	15.86	16.34	2,228	**53.00**	1,264.18	36,784.57
4354	**22.36**	23.03	23.72	394	**75.00**	2,597.44	11,723.43
2096	**19.67**	20.26	20.87	382	**74.00**	2,254.49	10,038.17
2487	**21.27**	21.91	22.57	398	**99.00**	3,261.49	12,032.64
3004	**18.08**	18.62	19.18	2,332	**175.00**	4,900.60	48,557.40
0463	**17.73**	18.26	18.81	2,171	**23.00**	631.61	40,478.00
0760	**17.10**	17.61	18.14	2,080	0.00	-	36,818.22
0200	**18.00**	18.54	19.10	2,145	**46.00**	1,282.46	41,252.80
3262	**17.99**	18.53	19.09	2,080	0.00	-	38,734.48
3672	**20.82**	21.44	22.09	389	**2.00**	64.49	8,442.75
4706	**17.23**	17.75	18.28	2,080	**1.00**	26.69	37,124.87
2422	**23.68**	24.39	25.12	2,914	**206.00**	7,555.48	79,003.31
2721	**23.46**	24.16	24.89	2,412	**4.00**	145.35	58,720.21
0455	**19.06**	19.63	20.22	1,509	0.00	-	29,768.56
4278	**22.16**	22.82	23.51	303	0.00	-	6,951.64

ATMOS ENERGY CORPORATION
TRA DOCKET #12-00064
SALARY AND WAGE PRICEOUT - HOURLY EMPLOYEES
ATTRITION YEAR 12/01/12 - 11/30/13
CONFIDENTIAL

E-PAY-1

EMP #	RATE AT 3/31/12	RATE AT 10/1/12	RATE AT 10/1/13	ANNUAL HOURS REG	ANNUAL HOURS 1.5 X OVERTIME	OVERTIME	ATTRITION PERIOD PAY
4284	**18.62**	19.18	19.75	2,080	**5.00**	144.20	40,235.50
3151	**24.34**	25.07	25.82	2,479	**61.00**	2,299.66	64,765.16
4390	**19.60**	20.19	20.79	1,986	**1.00**	30.36	40,324.27
2289	**23.25**	23.95	24.67	2,418	**61.00**	2,196.67	60,396.73
0138	**30.10**	31.00	31.93	2,080	**63.00**	2,937.11	67,753.10
4832	**26.65**	27.45	28.27	2,092	**46.00**	1,898.75	59,614.96
2108	**27.35**	28.17	29.02	2,221	**249.00**	10,547.99	73,453.80
0418	**23.90**	24.62	25.36	2328	**154.00**	5,700.74	63,309.88
3528	**24.18**	24.91	25.65	2131	**86.00**	3,220.83	56,567.64
4741	**24.40**	25.13	25.89	2342	**80.00**	3,023.38	62,184.36
1505	**23.69**	24.40	25.13	2080	0.00	-	51,007.22
3647	**28.19**	29.04	29.91	2080	**50.00**	2,183.12	62,884.79
4656	**19.49**	20.07	20.68	2080	**2.00**	60.37	42,024.68
4528	**24.09**	24.81	25.56	2328	**94.00**	3,507.34	61,568.87
1510	**19.25**	19.83	20.42	2268	**53.00**	1,580.23	46,777.78
1635	**24.33**	25.06	25.81	1575	**88.00**	3,316.18	42,991.14
3667	**36.80**	37.90	39.04	2080	0.00	-	79,234.52
2145	**25.88**	26.66	27.46	2396	**71.00**	2,846.00	67,041.18
3430	**26.63**	27.43	28.25	2337	**95.00**	3,918.39	68,350.01
4382	**24.53**	25.27	26.02	2226	**97.00**	3,685.38	60,217.67
2581	**26.51**	27.31	28.12	2487	**10.00**	410.60	68,659.45
1935	**21.57**	22.22	22.88	2083	**15.00**	501.13	47,011.99
1866	**25.26**	26.02	26.80	2080	**2.00**	78.25	54,466.05
1878	**30.33**	31.24	32.18	2080	**80.00**	3,758.16	69,071.42
4179	**21.67**	22.32	22.99	2227	**64.00**	2,148.09	52,108.84
2159	**26.03**	26.81	27.62	2091	**21.00**	846.65	57,190.67

ATMOS ENERGY CORPORATION
TRA DOCKET #12-00064
SALARY AND WAGE PRICEOUT - HOURLY EMPLOYEES
ATTRITION YEAR 12/01/12 - 11/30/13
CONFIDENTIAL

E-PAY-1

EMP #	RATE AT 3/31/12	RATE AT 10/1/12	RATE AT 10/1/13	ANNUAL HOURS REG	ANNUAL HOURS 1.5 X OVERTIME	OVERTIME	ATTRITION PERIOD PAY
4385	**29.99**	30.89	31.82	2152	**33.00**	1,532.86	68,343.69
4002	**23.70**	24.41	25.14	2149	**49.00**	1,798.69	54,524.71
4350	**23.69**	24.40	25.13	2318	**58.00**	2,128.17	58,977.10
2995	**25.84**	26.62	27.41	2206	**8.00**	320.18	59,327.68
2828	**26.78**	27.58	28.41	1686	**82.00**	3,401.24	50,147.86
2996	**27.89**	28.73	29.59	2066	0.00	-	59,646.11
0857	**26.91**	27.72	28.55	2080	**9.00**	375.12	58,316.30
1759	**25.48**	26.24	27.03	2305	**84.00**	3,315.06	64,119.14
0173	**26.02**	26.80	27.60	2197	**104.00**	4,191.35	63,377.12
4078	**27.03**	27.84	28.68	2210	**35.00**	1,465.30	63,304.99
4707	**22.47**	23.14	23.84	2253	**70.00**	2,436.21	54,846.66
1222	**28.56**	29.42	30.30	2080	**8.00**	353.88	61,847.65
4200	**24.35**	25.08	25.83	2139	**110.00**	4,148.63	58,074.40
0560	**23.90**	24.62	25.36	2267	**55.00**	2,035.98	58,126.83
1208	**30.13**	31.03	31.96	2087	**102.00**	4,760.06	69,863.52
3476	**20.70**	21.32	21.96	2068	**18.00**	577.11	44,890.83
2575	**23.86**	24.58	25.31	2345	**24.00**	886.94	58,807.55
3543	**21.66**	22.31	22.98	2080	0.00	-	46,636.41
0103	**23.69**	24.40	25.13	2100	**40.00**	1,467.70	52,969.04
1006	**27.69**	28.52	29.38	2107	**22.00**	943.54	61,339.47
4185	**28.19**	29.04	29.91	2100	0.00	-	61,279.84
0184	**26.04**	26.82	27.63	2173	**107.00**	4,315.56	62,900.21
1839	**24.00**	24.72	25.46	2341	**6.00**	223.04	58,382.46
2831	**23.36**	24.06	24.78	2405	**64.00**	2,315.61	60,476.94
3802	**24.47**	25.20	25.96	2306	**50.00**	1,895.03	60,311.02
0352	**22.58**	23.26	23.96	2106	**61.00**	2,133.37	51,363.68

ATMOS ENERGY CORPORATION
TRA DOCKET #12-00064
SALARY AND WAGE PRICEOUT - HOURLY EMPLOYEES
ATTRITION YEAR 12/01/12 - 11/30/13
CONFIDENTIAL

E-PAY-1

EMP #	RATE AT 3/31/12	RATE AT 10/1/12	RATE AT 10/1/13	ANNUAL HOURS REG	ANNUAL HOURS 1.5 X OVERTIME	OVERTIME	ATTRITION PERIOD PAY
4249	**22.55**	23.23	23.92	2382	**31.00**	1,082.73	56,687.58
1887	**21.94**	22.60	23.28	2324	**70.00**	2,378.74	55,165.48
4644	**25.00**	25.75	26.52	2094	**33.00**	1,277.81	55,471.10
3739	**25.76**	26.53	27.33	2135	**14.00**	558.58	57,490.74
1073	**28.88**	29.75	30.64	2569	**63.00**	2,818.06	79,625.68
2013	**21.99**	22.65	23.33	2080	0.00	-	47,346.93
1961	**23.71**	24.42	25.15	2089	**28.00**	1,028.26	52,302.00
2826	**30.36**	31.27	32.21	2080	**19.00**	893.45	66,264.15
3064	**26.01**	26.79	27.59	2115	**113.00**	4,552.31	61,508.45
1648	**26.94**	27.75	28.58	2080	**120.00**	5,007.16	63,024.49
4379	**25.33**	26.09	26.87	2583	**95.00**	3,727.11	71,463.56
0680	**23.90**	24.62	25.36	1025	**42.00**	1,554.75	26,917.21
4483	**23.71**	24.42	25.15	445	**11.00**	403.96	11,326.78
0646	**24.08**	24.80	25.55	1862	**15.00**	559.45	46,973.82
4260	**21.63**	22.28	22.95	1042	**1.00**	33.50	23,364.27
0220	**24.10**	24.82	25.57	598	**20.00**	746.55	15,666.79
1888	**23.90**	24.62	25.36	249	0.00	-	6,160.28
0657	**23.32**	24.02	24.74	759	**52.00**	1,878.21	20,204.93
3110	**27.28**	28.10	28.94	491	**30.00**	1,267.59	15,136.05
2085	**27.15**	27.96	28.80	739	**25.00**	1,051.29	21,823.01
0360	**24.26**	24.99	25.74	1,928	**2.00**	75.15	48,492.70
3400	**26.03**	26.81	27.62	1,027	**27.00**	1,088.56	28,763.74
0909	**32.16**	33.12	34.11	387	0.00	-	12,873.15
3675	**28.72**	29.58	30.47	401	**19.00**	845.18	12,768.82
			Total		5,258.00	187,747.44	$5,476,797.00

Sources: MFR #31.

ATMOS ENERGY CORPORATION
TRA DOCKET #12-00064
SALARY AND WAGE PRICEOUT - SALARIED EMPLOYEES
ATTRITION YEAR 12/01/12 - 11/30/13
CONSOLIDATED

AVERAGE WAGE INCREASE: 3.0%
EFFECTIVE DATE: 10/01/12 - 10/01/13
APPLIES TO ALL SALARIED EMPLOYEES

E-PAY-2

[redacted]

ATMOS ENERGY CORPORATION
TRA DOCKET #12-00064
OPERATIONS AND MAINTENANCE LABOR
FOR ATTRITION YEAR ENDING 11/30/13

E-PAY-5

	PAYROLL CONSUMER ADVOCATE	
HOURLY EMPLOYEES	$ 5,476,797	A/
SALARIED EMPLOYEES	2,043,860	B/
SHIFT DIFFERENTIAL	23,062	C/
TOTAL	$ 7,543,719	
CAPITALIZATION %	50.52%	D/
CAPITALIZED PORTION	3,811,087	
EXPENSED PORTION	$ 3,732,632	

A/ CONSUMER ADVOCATE WORK PAPER E-PAY-1.
B/ CONSUMER ADVOCATE WORK PAPER E-PAY-2.
C/ MFR #31
D/ MFR #32

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
STORAGE AND TRANSMISSION COMPANY 93 NON-LABOR EXPENSE SUMMARY
ATMOS ENERGY COMPANY TRA DOCKET #12-00064
FOR THE ATTRITION YEAR ENDED NOVEMBER 2013 **E-S&T**

ACCOUNT #	DESCRIPTION	A/ 12 MTD 3/31/12 AMOUNTS	B/ INFLATION FACTOR	C/ GROWTH FACTOR	CONSUMER ADVOCATE ATTR YR AMOUNTS
7350	Miscellaneous general exp	$ 1,291	$ 46	$ 6	$ 1,343
7510	Operation-Maps	22	1	0	23
8170	Lines expenses		-	0	0
8180	Compressor		-	0	0
8190	Compressor		-	0	0
8200	Storage-Measuring		-	0	0
8210	Storage-Purificati		-	0	0
8240	Storage-Other		-	0	0
8250	Storage-well		-	0	0
8260	Storage-Rents		-	0	0
8910	Maintenance of measuring		-	0	0
8860	Distribution-Maintenance		-	0	0
8711	Odorization	21,787	780	100	22,668
8660	Transmission		-	0	0
8560	Mains expenses	11,821	423	54	12,299
8570	Transmission		-	0	0
8650	Transmission		-	0	0
8700	Distribution-Operation su	1,469,505	52,608	6,760	1,528,874
8710	Distribution load dispatc		-	0	0
8740	Mains and Services Expens	780,287	27,934	3,589	811,811
8750	Distribution-Measuring an	42,980	1,539	198	44,717
8760	Distribution-Measuring an		-	0	0
8770	Distribution-Measuring an	3,087	111	14	3,211
8780	Meter and house regulator	3,582	128	16	3,726
8790	Customer installations ex		-	0	0
8800	Distribution-Other expens	149,852	5,365	689	155,907

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
STORAGE AND TRANSMISSION COMPANY 93 NON-LABOR EXPENSE SUMMARY
ATMOS ENERGY COMPANY TRA DOCKET #12-00064
FOR THE ATTRITION YEAR ENDED NOVEMBER 2013 E-S&T

ACCOUNT #	DESCRIPTION	A/ 12 MTD 3/31/12 AMOUNTS	B/ INFLATION FACTOR	C/ GROWTH FACTOR	CONSUMER ADVOCATE ATTR YR AMOUNTS
8810	Distribution-Rents	**261,373**	9,357	1,202	271,933
8860	Distribution-Maintenance	**21,632**	774	100	22,505
8870	Distribution-Maint of mai	**61,154**	2,189	281	63,625
8890	Maintenance of measuring	**328**	12	2	341
8900	Maintenance of measuring	**205**	7	1	214
8910/8920	Maintenance of measuring	**15,639**	560	72	16,271
8930	Maintenance of meters and	**2,542**	91	12	2,644
8940	Distribution-Maintenance	**(923)**	(33)	(4)	(961)
8400	Other storage-Oper		-	0	0
	Total	$ **2,846,164**	$ 101,893	$ 13,092	$ 2,961,149

A/ Atmos response to TRA, amounts by FERC accounts by Company .
B/ Terry Buckner work paper E-GDP, 2.12% for 20 months growth.
C/ Hal Novak work paper, .55% at 50% for 20 months growth.

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
CUSTOMER ACCOUNTS COMPANY 93-NON-LABOR EXPENSE SUMMARY
ATMOS ENERGY COMPANY TRA DOCKET #12-00064
FOR THE ATTRITION YEAR ENDED NOVEMBER 2013

E-CA

ACCOUNT #	DESCRIPTION	A/ 12 MTD 3/31/12 AMOUNTS	ADJUSTMENTS	B/ INFLATION FACTOR	C/ GROWTH FACTOR	ATTRITION YR AMOUNTS
9010	Customer accounts-Operati					
9020	Customer accounts-Meter r	$ 27,203		$ 974	$ 125	$ 28,302
9030	Customer accounts-Custome	18,371		658	85	19,113
9040	Customer accounts-Uncolle	282,504				282,504
9050	Customer accounts-Miscell			-	0	0
9070	Customer service-Supervis			-	0	0
9080	Customer service-Operatin	2,215		79	10	2,304
9090	Customer service-Operatin	24,705		884	114	25,703
9100	Customer service-Miscella	65		2	0	68
	Total	$ 355,063		$ 2,598	$ 334	$ 357,994

A/ Atmos response to TRA, amounts by FERC accounts by Company .
B/ Terry Buckner work paper E-GDP, 2.12% for 20 months growth.
C/ Hal Novak work paper, .55% at 50% for 20 months growth.

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
SALES EXPENSE COMPANY 93-NONLABOR SUMMARY
ATMOS ENERGY COMPANY TRA DOCKET #12-00064
FOR THE ATTRITION YEAR ENDED NOVEMBER 2013

E-SALES

DESCRIPTION	A/ 12 MTD 3/31/12 AMOUNTS	ADJUSTMENTS	B/ INFLATION FACTOR	C/ GROWTH FACTOR	ATTR YR AMOUNTS
Sales-Supervision	$ 79,947		$ 2,862	$ 368	$ 83,177
Sales-Demonstrating and s	18,873		676	87	19,636
Sales-Advertising expense	200		7	1	208
Sales-Miscellaneous sales	533		19	2	555
Total	**$ 99,554**	$ -	$ 3,564	$ 458	**$ 103,575**

A/ Atmos response to TRA, amounts by FERC accounts by Company .
B/ Terry Buckner work paper E-GDP, 2.12% for 20 months growth.
C/ Hal Novak work paper, .55% at 50% for 20 months growth.

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
ADMISTRATION AND GENERAL EXPENSE COMPANY 93- NON-LABOR SUMMARY
ATMOS ENERGY COMPANY TRA DOCKET #12-00064
FOR THE ATTRITION YEAR ENDED NOVEMBER 2013

E-A&G

ACCOUNT #	DESCRIPTION	A/ 3/31/12 AMOUNTS	B/ ADJUSTMENTS	C/ INFLATION FACTOR	D/ GROWTH FACTOR	ATTR YR AMOUNTS
9200	A&G-Administrative & gene			$ -	$ -	$ -
9210	A&G-Office supplies & exp	**78,626**		2,815	362	
9220	A&G-Administrative expens			-	0	**0**
9230	A&G-Outside services empl	**195,427**	**(18,672)**	6,328	899	**183,982**
9240	A&G-Property insurance	**122,427**		4,383	563	**127,373**
9250	A&G-Injuries & damages	**5,068**		181	23	**5,272**
9260	A&G-Employee pensions and	**1,712,003**	**(305,191)**	61,290	7,875	**1,475,977**
9270	A&G-Franchise requirement			-	0	**0**
9280	A&G-Regulatory commission	**42,916**		1,536	197	**44,650**
9301	A&G-General advertising e	**579**		21	3	**602**
9302	Miscellaneous general exp	**19,516**		699	90	**20,304**
9310	A&G-Rents	**217,494**		7,786	1,000	**226,280**
9320	A&G-Maintenance of genera			-	0	**0**
	Total	**$ 2,394,056**	$ (323,863)	$ 85,039	$ 11,013	$ 2,084,441

A/ Atmos response to TRA, amounts by FERC accounts by Company .
B/ Atmos responses to Consumer Advocate DR #18 and DR #15.
C/ Terry Buckner work paper E-GDP, 2.12% for 20 months growth.

ATMOS ENERGY CORPORATION **E-RATE CASE**
TRA DOCKET #12-00064
RATE CASE EXPENSE RECONCILIATION
FOR THE ATTRITION YEAR ENDING NOVEMBER 2013

	TOTAL		ATTRITION YEAR AMORTIZATION	
TRA DOCKET #12-00064	$ 460,000	A/	153,333	B/
TOTAL	$ 460,000		$ 153,333	

A/ Atmos WP THP 7-3.
B/ Atmos WP GW-2.

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
PENSION FUNDING SUMMARY
ATMOS ENERGY COMPANY TRA DOCKET #12-00064
FOR THE ATTRITION YEAR ENDED NOVEMBER 2013

E-PENSION

	Number of Participants	Estimated Liability	Percent of Contribution Applicable to Grou	Contribution	Allocation Factor to Tennesse	Amount Allocable to Tennessee
Total Atmos Contribution	7,027	$ 381,376,000	100.00%	$ 23,532,700		
All Other (not allocable to Tennessee)	5,391	293,510,000	76.96%	18,110,953		
Co 010 - Shared Services	609	41,113,000	10.78%	2,536,866	4.44%	$ 112,750
Co 010 - CSO	534	6,827,000	1.79%	421,258	4.25%	17,903
Active Tennessee Jurisdiction Employees	144	11,871,000	3.11%	732,497	100.00%	732,497
Inactive Tennessee Jurisdiction Employees	242	16,367,000	4.29%	1,009,921	100.00%	1,009,921
Active Division General Office Employees	28	3,389,000	0.89%	209,117	34.48%	72,103
Inactive Division General Office Employees (pre-merger	73	7,137,000	1.87%	440,387	26.55%	116,923
Inactive Division General Office Employees (post-merge	6	1,162,000	0.30%	71,701	34.48%	24,722
Total Amount of Contribution Allocable to Tennessee	7,027	$ 381,376,000	100.00%	33,600,000		$ 2,086,819

1 For General Office employees who worked at United Cities Gas Company prior to the merger with Atmos Energy, the Company has applied the allocation factor used to allocate labor expense in Docket No. 95-02258.

Source: MFR #12. Attachment 3, Waller

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
COMPANY 02-SUMMARY
ATMOS ENERGY COMPANY TRA DOCKET #12-00064
FOR THE ATTRITION YEAR ENDED NOVEMBER 2013

E-COMPANY 02

ACCOUNT #	DESCRIPTION	A/ 12 MTD 3/31/12 AMOUNTS	B/ INFLATION FACTOR	C/ GROWTH FACTOR	ATTR YR AMOUNTS
	TOTAL	$ **66,094,895**			
	Less: FAS 87	11,056,943			
A&G-Employee pensio	- Variable Pay & Mgmt Incentive Plans 9260-07452	5,515,532.73			
A&G-Employee pensio	- Exec Compensation-Other 9260-07453	461.00			
A&G-Employee pensio	- Restricted Stock -Long Term Incentive P 9260-07456	48,443.52			
A&G-Employee pensio	- Restricted Stock - Management Incentive 9260-07457	157,470.19			
A&G-Employee pensio	- Restricted Stock - Long Term Incentive 9260-07458	2,945,110.92			
A&G-Employee pensio	- RSU-Long Term Incentive Plan - Time Lap 9260-07460	2,809,068.55			
A&G-Employee pensio	- RSU-Managment Incentive Plan 9260-07463	671,035.13			
	Total Adjustments	23,204,065			
	Net Company 02	$ 42,890,830	1,535,492	197,298	44,623,620
	Company 93 Allocation Factor				4.44%
	Total Company 93 Amount				$ 1,983,275

A/ Atmos response to TRA, amounts by FERC accounts by Company .
B/ Terry Buckner work paper E-GDP, 2.12% for 20 months growth.
C/ Hal Novak work paper, .55% at 50% for 20 months growth.

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
COMPANY 12-SUMMARY
ATMOS ENERGY COMPANY TRA DOCKET #12-00064
FOR THE ATTRITION YEAR ENDED NOVEMBER 2013

E-COMPANY 12

ACCOUNT #	DESCRIPTION	A/ 12 MTD 3/31/12 AMOUNTS	B/ INFLATION FACTOR	C/ GROWTH FACTOR	ATTR YR AMOUNTS
	TOTAL	$ 44,606,387			
	Less:				
	FAS 87	1,687,934			
	A&G-Employee pensio - Variable Pay & Mgmt Incentive Plans 9260-07452	11,889			
	A&G-Employee pensio - Restricted Stock -Long Term Incentive P 9260-0745	3,052			
	A&G-Employee pensio - Restricted Stock - Management Incentive 9260-0745	16,747			
	A&G-Employee pensio - Restricted Stock - Long Term Incentive 9260-07458	169,326			
	A&G-Employee pensio - RSU-Long Term Incentive Plan - Time Lap 9260-07	170,608			
	A&G-Employee pensio - RSU-Managment Incentive Plan 9260-07463	91,998			
	Total Adjustments	2,151,554			
	Net Company 12	$ 42,454,832	1,519,883	195,292	44,170,008
	Company 93 Allocation Factor				4.25%
	Total Company 93 Amount				$ 1,877,209

A/ Atmos response to TRA, amounts by FERC accounts by Company .
B/ Terry Buckner work paper E-GDP, 2.12% for 20 months growth.
C/ Hal Novak work paper, .55% at 50% for 20 months growth.

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
COMPANY 91-SUMMARY
ATMOS ENERGY COMPANY TRA DOCKET #12-00064
FOR THE ATTRITION YEAR ENDED NOVEMBER 2013

E-COMPANY 91

ACCOUNT #	DESCRIPTION	A/ 12 MTD 3/31/12 AMOUNTS	B/ INFLATION FACTOR	C/ GROWTH FACTOR	ATTR YR AMOUNTS
	TOTAL	**$ 10,670,625**			
	Less:				
	FAS 87	470,646			
	A&G-Employee pensio - Capitalized Restricted Stock 9260-07450	(163,387)			
	A&G-Employee pensio - Variable Pay & Mgmt Incentive Plans 9260-07452	643,251			
	A&G-Employee pensio - VPP & MIP - Capital Credit 9260-07454	(332,735)			
	A&G-Employee pensio - Restricted Stock -Long Term Incentive P 9260-07456	3,276			
	A&G-Employee pensio - Restricted Stock - Management Incentive 9260-07457	6,330			
	A&G-Employee pensio - Restricted Stock - Long Term Incentive 9260-07458	114,092			
	A&G-Employee pensio - RSU-Long Term Incentive Plan - Time Lap 9260-074	130,386			
	Total Adjustments	$ 871,858			
	Net Company 91	$ 9,798,767	350,796	45,074	10,194,637
	Company 93 Allocation Factor				34.48%
	Total Company 93 Amount				$ 3,515,095

A/ Atmos response to TRA, amounts by FERC accounts by Company .
B/ Terry Buckner work paper E-GDP, 2.12% for 20 months growth.
C/ Hal Novak work paper, .55% at 50% for 20 months growth.

E-GDP

OFFICE OF THE ATTORNEY GENERAL - STATE OF TENNESSEE
CONSUMER ADVOCATE AND PROTECTION DIVISION
ANALYSIS OF THE GROSS DOMESTIC PRODUCT ("GDP") CHAINED PRICE DEFLATOR
ATMOS ENERGY COMPANY TRA DOCKET #12-00064
FOR THE ATTRITION YEAR ENDED NOVEMBER 30, 2013

	QUARTER				ATTR YR
YEAR	1/1 - 3/31	4/1 - 6/30	7/1 - 9/30	10/1 - 12/31	GDP IDP
2010	110.216	110.706	111.238	111.795	110.9888
2011	112.372	113.109	113.950	113.987	113.3545
	AVERAGE GDP DEFLATOR FOR YEAR 2011				2.13%

Source: U.S. Department of Commerce, Bureau of Economic Analysis, Table 1.1.9

ATMOS ENERGY CORPORATION **T-OTAX0**

ATMOS ENERGY CORPORATION TRA DOCKET #12-00064

SUMMARY OF TAXES OTHER THAN INCOME

FOR THE ATTRITION YEAR ENDING NOVEMBER 2013

Tax	CONSUMER ADVOCATE AMOUNTS	
Property Tax	$ 3,270,467	A/
TRA Inspection Fee	422,746	B/
FUTA Taxes	3,429	C/
FICA Taxes	284,491	C/
SUTA Taxes	11,022	C/
Franchise Tax	617,385	D/
Gross Receipts Tax	1,319,687	E/
Allocated and Other Taxes	399,598	F/
Total	$ 6,328,824	

A/ Consumer Advocate work paper T-OTAX1.
B/ Consumer Advocate work paper T-OTAX2.
C/ Consumer Advocate work paper T-OTAX3.
D/ Consumer Advocate work paper T-OTAX6.
E/ Consumer Advocate work paper T-OTAX7.
F/ PER ATMOS SCHEDULE GW-3.

ATMOS ENERGY CORPORATION **T-OTAX1**
TRA DOCKET #12-00064
PROPERTY TAX
FOR THE ATTRITION YEAR NOVEMBER 2013

Year	Property Tax Amount		Gross Assessment		Percentage of Property Tax to Assessment
2000	2,042,758	A/	62,400,000	A/	3.2737%
2001	2,048,520	A/	62,400,000	A/	3.2829%
2002	2,053,135	A/	63,388,000	A/	3.2390%
2003	2,082,654	A/	67,200,000	A/	3.0992%
2004	2,518,215	A/	73,000,000	A/	3.4496%
2005	2,589,126	A/	74,700,000	A/	3.4660%
2006	2,632,311	B/	79,300,000	A/	3.3194%
2007	2,704,325	C/	82,500,000	A/	3.2780%
2008	2,828,888	F/	86,300,000	A/	3.2780%
2009	2,964,325	F/	90,431,751	E/	3.2780%
2010	2,979,674	F/	90,900,000	A/	3.2780%
2011	3,005,506	G/	95,500,000	A/	3.1471%
2012	3,140,832	F/	99,800,000	A/	3.1471%
2013	3,282,252	F/	104,293,613		3.1471%
ATTRITION YR	$ 3,270,467	D/			

A/ PER OFFICE OF STATE ASSESSED PROPERTIES.

B/ DR #72.

C/ DR #40

D/ 11/12 OF 2013 ESTIMATED TAXES AND 1/12 OF 2012 ESTIMATED TAXES.

E/ ESTIMATED UNEQUALIZED ASSESSMENT. (2007/2006).

F/ ESTIMATED TAXES.

G/ Consumer Advocate DR #21.

ATMOS ENERGY CORPORATION
TRA DOCKET #12-00064
TRA INSPECTION FEE
FOR ATTRITION YEAR ENDING NOVEMBER 30, 2013

T-OTAX-2

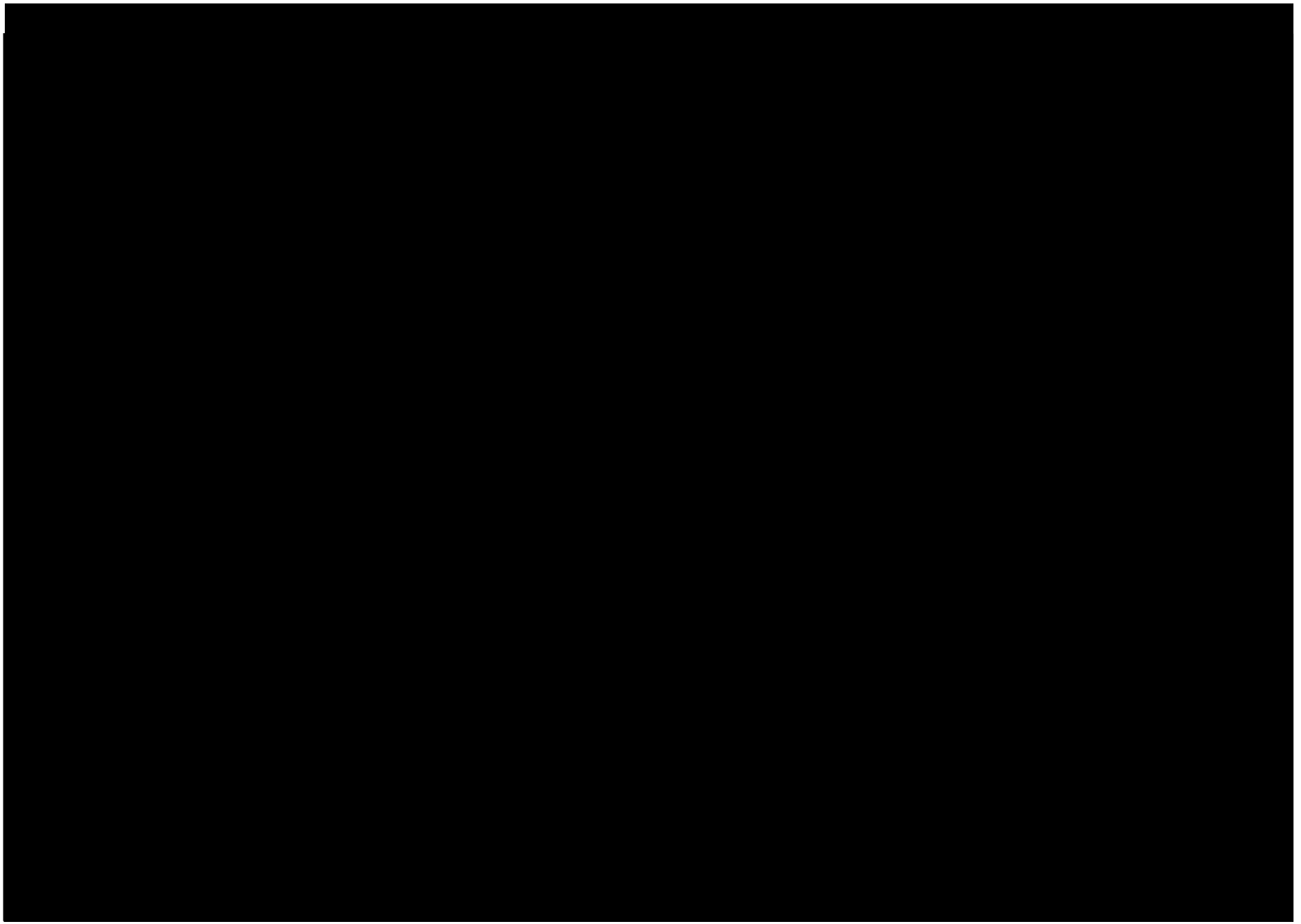
	AMOUNT
NET REVENUES	$ 129,772,944 B/
LESS: EXEMPTION	5,000
TAX BASE	$ 129,767,944
.425% OF FIRST $1,000,000	4,250
.325% OF EXCESS	418,496
TOTAL 2013 INSPECTION FEE	$ 422,746

A/ TRA March 2012 Surveillance Report

ATMOS ENERGY CORPORATION
TRA DOCKET #12-00064
COMPARISON OF PAYROLL TAXES
FOR ATTRITION YEAR ENDING 11/30/13

	CONSUMER ADVOCATE PAYROLL TAXES		ATMOS PAYROLL TAXES	
FICA & MEDICARE TAXES				
HOURLY EMPLOYEE	$ 418,975	A/		
SALARIED EMPLOYEES	155,986	B/		
TOTAL	$ 574,961		$ -	
CAPITALIZATION %	50.52%	C/	0.00%	
CAPITALIZED PORTION	$ 290,470		$ -	
EXPENSED PORTION	$ 284,491		$ 271,187	D/
FUTA TAXES				
HOURLY EMPLOYEES	5,376	A/	0	
SALARIED EMPLOYEES	1,554	B/	0	
TOTAL	6,930		0	
CAPITALIZATION %	50.52%	C/	0.00%	
CAPITALIZED PORTION	$ 3,501		$ -	
EXPENSED PORTION	$ 3,429		$ 4,119	D/
SUTA TAXES				
HOURLY EMPLOYEES	$ 17,280	A/	$ -	
SALARIED EMPLOYEES	4,995	B/	0	
TOTAL	$ 22,275		$ -	
CAPITALIZATION %	50.52%	C/	0.00%	
CAPITALIZED PORTION	$ 11,253		$ -	
EXPENSED PORTION	$ 11,022		$ 5,475	D/
TOTAL PAYROLL TAXES EXPENSED	$ 298,941		$ 280,781	

A/ Consumer Advocate WORK PAPER T-OTAX4
B/ Consumer Advocate WORK PAPER T-OTAX5
C/ MFR #29
D/ Atmos SCHEDULE GW-3



[redacted]

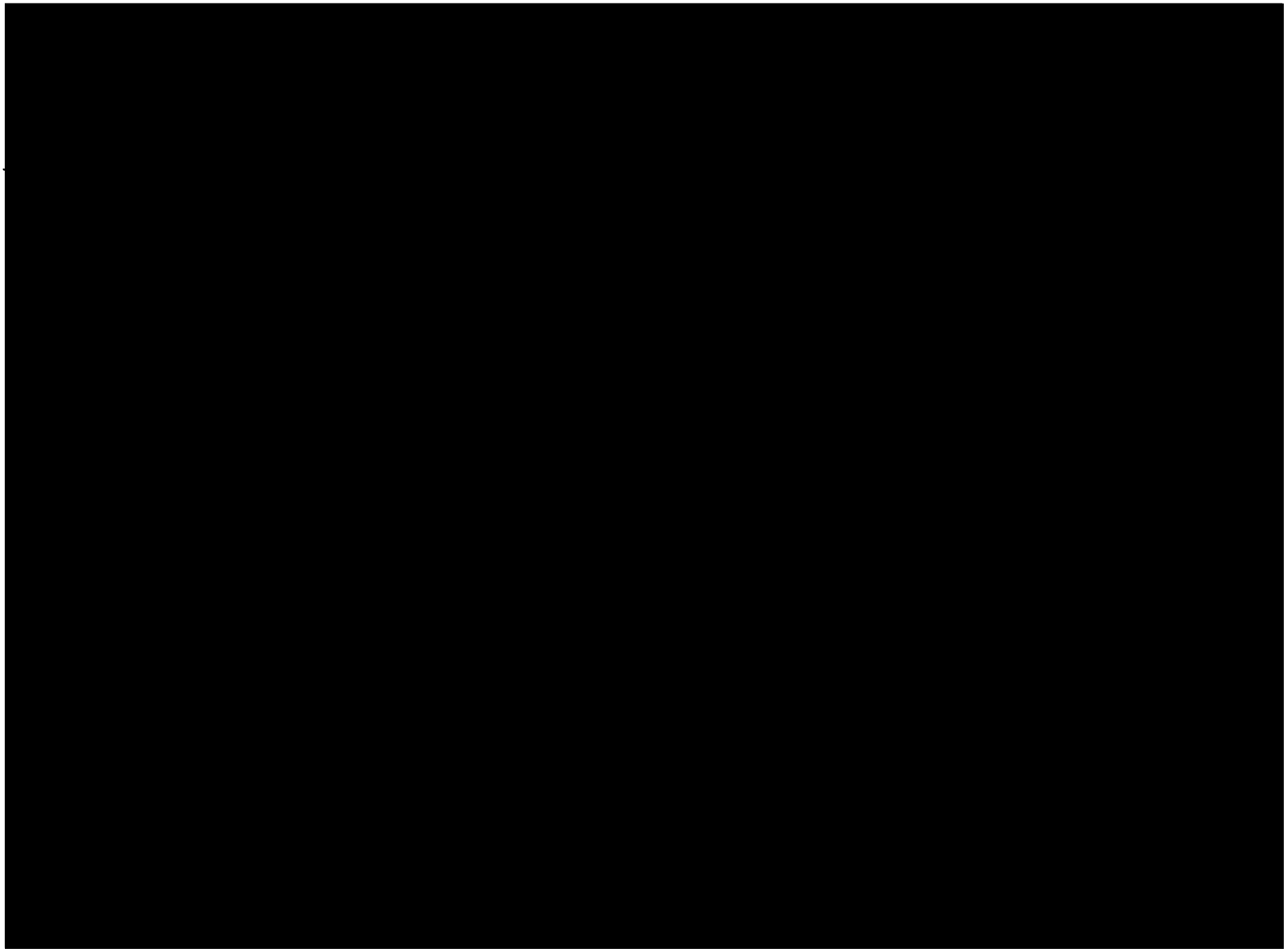
[redacted]

[redacted]

[redacted]

[redacted]

ATMOS ENERGY CORPORATION
TRA DOCKET #12-00064
PAYROLL TAXES - SALARIED EMPLOYEES
ATTRITION YEAR 12/01/12 - 11/30/13 CONFIDENTIAL T-OTAX5



ATMOS ENERGY CORPORATION
TRA DOCKET #12-00064
FRANCHISE TAX

CONFIDENTIAL



Atmos Energy Corporation
TRA DOCKET #12-00064
State of Tennessee Gross Receipts Tax Calculation
FOR THE ATTRITION YEAR ENDING NOVEMBER 30, 2013

T-OTAX7

	2013 Forecast	2012 Forecast
Gross Receipts	$ 129,772,944 B/	$ 133,053,074 A/
Taxable Receipts	129,772,944	133,053,074
Tax Rate	1.50%	1.50%
Taxes	1,946,594	1,995,796
Less:Franchise Tax	(596,693) C/	(697,690) C/
Excise Tax	-	-
Net Tax	$ 1,349,902	$ 1,298,106
Tax 7/1/13-6/30/14	$ 562,459	
Tax 7/1/12-6/30/13		$ 757,228
Total Tax	$ 1,319,687	

A/ TRA September 2011 Surveillance Report
B/ TRA March 2012 Surveillance Report
C/ Consumer Advocate work paper T-OTAX6

APPENDIX

ATMOS energy

December 22, 2011

Dear Atmos Energy Shareholder:

You are cordially invited to attend the annual meeting of shareholders on Wednesday, February 8, 2012, at 9:30 a.m. Central Standard Time. The meeting will be held in the Lincoln Ballroom at the Hilton Hotel Lincoln Centre, 5410 LBJ Freeway, Dallas, Texas 75240.

The matters to be acted upon at the meeting are described in the Notice of Annual Meeting of Shareholders and Proxy Statement. In addition, we will review the affairs and progress of the Company during the past year and discuss the results of operations for the first quarter of our 2012 fiscal year.

Your vote is very important, regardless of the number of shares you hold. Whether or not you plan to attend the meeting in person, please cast your vote, as instructed in the Notice of Internet Availability of Proxy Materials ("Notice") or proxy card, over the Internet, by telephone or on the proxy card, as promptly as possible. If you received only a Notice in the mail or by electronic mail, you may also request a paper proxy card to submit your vote by mail, if you prefer. However, we encourage you to vote over the Internet or by telephone because it is more convenient and saves printing costs and postage fees, as well as natural resources.

On behalf of your Board of Directors, thank you for your continued support and interest in Atmos Energy Corporation.

Sincerely,

Robert W. Best

Robert W. Best
Executive Chairman of the Board

Kim R. Cocklin

Kim R. Cocklin
President and Chief Executive Officer

ATMOS ENERGY CORPORATION
P.O. Box 650205
Dallas, Texas 75265-0205

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

To Our Shareholders:

The annual meeting of the shareholders of Atmos Energy Corporation will be held in the Lincoln Ballroom at the Hilton Hotel Lincoln Centre, 5410 LBJ Freeway, Dallas, Texas 75240 on Wednesday, February 8, 2012, at 9:30 a.m. Central Standard Time for the following purposes:

1. To elect eight directors for one-year terms expiring in 2013;
2. To ratify the Audit Committee's appointment of Ernst & Young LLP ("Ernst & Young") to serve as the Company's independent registered public accounting firm for fiscal 2012;
3. To act upon a proposal for a non-binding, advisory vote by the shareholders to approve the compensation of the named executive officers of the Company for fiscal 2011 ("Say on Pay"); and
4. To transact such other business as may properly come before the meeting or any adjournment thereof.

Shareholders of record of our common stock at the close of business on December 12, 2011, will be entitled to notice of, and to vote at, such meeting. The stock transfer books will not be closed. Your vote is very important to us. Regardless of the number of shares you own, please vote. All shareholders of record may vote (i) over the Internet, (ii) by toll-free telephone (please see the proxy card for instructions), (iii) by written proxy by signing and dating the proxy card and mailing it to us or (iv) by attending the annual meeting and voting in person. These various options for voting are described in the Notice or proxy card. For all shareholders who participate in our Retirement Savings Plan and Trust ("RSP"), your vote over the Internet, by telephone or on your proxy card will serve as voting instructions to the trustee of the RSP. If you have shares of our common stock issued to you under the RSP, only the trustee may vote your plan shares even if you attend the annual meeting in person.

All shareholders who hold their shares in "street name" in the name of a broker, bank or other nominee ("broker") may submit their written votes through voting instruction forms provided by their brokers. If you hold your shares in street name, you may also generally vote your proxy over the Internet or by telephone, in accordance with voting instructions provided by your broker. Pursuant to recent amendments of the rules of the New York Stock Exchange ("NYSE"), brokers no longer have the discretion to vote the shares of customers who fail to provide voting instructions on any of the proposals listed above except the proposal to ratify the Audit Committee's appointment of Ernst & Young to serve as the Company's independent registered public accounting firm for fiscal 2012. Therefore, if you do not provide instructions to your broker to vote your shares, the broker may vote your shares only on that one proposal at our annual meeting. In addition, if you own your shares in street name and you intend to vote in person at the meeting, you must first obtain a legal proxy from your broker and bring that legal proxy to the annual meeting.

We encourage you to receive all proxy materials in the future electronically to help us save printing costs and postage fees, as well as natural resources in producing and distributing these materials. If you wish to receive these materials electronically next year, please follow the instructions on the proxy card or on our website at *www.atmosenergy.com.*

By Order of the Board of Directors,

Dwala Kuhn

Dwala Kuhn
Corporate Secretary

December 22, 2011

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ATMOS ENERGY CORPORATION
P.O. Box 650205
Dallas, Texas 75265-0205

PROXY STATEMENT
for the
2012 ANNUAL MEETING OF SHAREHOLDERS
to he Held on February 8, 2012

GENERAL MEETING MATTERS

Date, Time, Place and Purpose of Meeting

Our 2012 annual meeting of shareholders will be held on Wednesday, February 8, 2012, at 9:30 a.m. Central Standard Time in the Lincoln Ballroom at the Hilton Hotel Lincoln Centre, 5410 LBJ Freeway, Dallas, Texas 75240. The purpose of the 2012 annual meeting is set forth in the Notice of Annual Meeting of Shareholders to which this proxy statement is attached. Atmos Energy Corporation is referred to as "Atmos Energy," the "Company," "our," "us" or "we" in this proxy statement.

Internet Availability of Proxy Materials

Under rules of the U.S. Securities and Exchange Commission ("SEC"), we are furnishing proxy materials to our shareholders primarily over the Internet, rather than mailing paper copies of the materials (including our Summary Annual Report and Annual Report on Form 10-K for fiscal 2011) to each shareholder. If you received only a Notice by mail or electronic mail, you will not receive a paper copy of these proxy materials unless you request one. Instead, the Notice will instruct you as to how you may access and review the proxy materials on the Internet. The Notice will also instruct you as to how you may access your proxy card to vote over the Internet. If you received a Notice by mail or electronic mail and would like to receive a paper copy of our proxy materials, free of charge, please follow the instructions included in the Notice.

We anticipate that the Notice will be mailed to our shareholders on or about December 22, 2011, and will be sent by electronic mail to our shareholders who have opted for such means of delivery on or about December 23, 2011.

Revocability and Voting of Proxies

Any shareholder of record giving a proxy has the power to revoke the proxy at any time prior to its exercise by (1) submitting a new proxy with a later date, including a proxy given over the Internet or by telephone; (2) notifying our Corporate Secretary in writing before the meeting; or (3) voting in person at the meeting. Any shareholder owning shares in street name who wishes to revoke voting instructions previously given to a broker should contact such broker for further instructions. An independent inspector will count the votes. Your vote will not be disclosed to us and will remain confidential except under special circumstances. For example, a copy of your proxy card will be sent to us if you add any written comments to the card. If you are a shareholder of record and give us your signed proxy, but do not specify how to vote on any particular proposal, we will vote your shares in favor of the nominees for the election of directors (see "*Proposal One—Election of Directors*," beginning on page 13), in favor of the proposal to ratify the Audit Committee's appointment of Ernst & Young as the independent registered public accounting firm for the Company for fiscal 2012 (see "*Proposal Two—Ratification of Appointment of Independent Registered Public Accounting Firm*" on page 56) and in favor of the advisory proposal to approve executive compensation for fiscal 2011 (see "*Proposal Three—Non-Binding, Advisory Vote on Approval of Executive Compensation,*" beginning on page 57).

Solicitation of Proxies

The proxy accompanying this statement is solicited by the management of the Company at the direction of our Board of Directors. It is expected that these materials will be first sent to our shareholders on or about December 22, 2011. We expect to solicit proxies primarily by mail, but our directors, officers, employees and agents may also solicit proxies in person or by telephone or other electronic means. We will pay for all costs of preparing, assembling and distributing the proxies and accompanying materials for the annual meeting of shareholders, including the costs of reimbursing brokers for forwarding proxies and proxy materials to their principals. We will ask brokers to prepare and send a Notice to customers or clients for whom they hold shares and forward copies of the proxy materials to such beneficial owners who request a paper copy. In addition, Morrow & Co., LLC, 470 West Avenue, Stamford, Connecticut 06902 ("Morrow") will assist us in the solicitation of proxies. We will pay approximately $7,500 in fees, plus expenses and disbursements, to Morrow for its proxy solicitation services.

Common Stock Information; Record Date

As of December 12, 2011, onr record date, there were 90,218,531 shares of our common stock, no par value, issued and outstanding, all of which are entitled to vote. These shares constitute the only class of our stock issued and outstanding. As stated in the Notice, only shareholders of record at the close of business on December 12, 2011, will be entitled to vote at the meeting. Eacb share is entitled to one vote.

Quorum Requirement

Our bylaws provide that if the holders of a majority of the issued and outstanding shares of our common stock entitled to vote are present in person or represented by proxy, there will be a quorum. The aggregate number of votes entitled to be cast by all shareholders present in person or represented by proxy at the annual meeting, whether those shareholders vote for, against or abstain from voting on any matter, will be counted for purposes of determining whether a quorum exists. Broker non-votes, which are described below, will also be considered present for purposes of determining whether a quorum exists.

Broker Non-Votes and Vote Required

If a broker holds your shares and you have previously elected to receive a paper copy of your proxy materials, this proxy statement and other proxy materials have been sent to your broker. You may have received this proxy statement directly from your broker, together with instructions as to how to direct the broker to vote your shares. If you desire to have your vote counted, it is important that you return your voting instructions to your broker. Rules of the NYSE determine whether proposals presented at shareholder meetings are considered "routine" or "non-routine." If a proposal is routine, a broker holding shares for an owner in street name may vote on the proposal without voting instructions from the owner. If a proposal is non-routine, the broker may vote on the proposal only if the owner has provided voting instructions. A "broker non-vote" occurs when the broker is unable to vote on a proposal because the proposal is non-routine and the owner does not provide instructions. Broker non-votes have no effect on the vote on such a proposal because they are not considered present and entitled to vote. Proposals One and Three are considered non-routine proposals. Therefore, brokers may vote on these proposals only if voting instructions are provided by the owner of the shares. Only Proposal Two, the proposal to ratify the appointment of Ernst & Young as the independent registered

public accounting firm for the Company for fiscal 2012, is considered a routine proposal under the rules of the NYSE. As a result, brokers holding shares for an owner in street name may vote on Proposal Two, even if no voting instructions are provided by the owner of the shares.

For all proposals, the number of votes required for approval is a majority of the shares of our common stock present or represented by proxy and entitled to vote at the meeting. Abstentions will have the same effect as an "against" vote but, as discussed above, broker non-votes will have no effect on the vote for these proposals. If any other proposals are properly presented to the shareholders at the meeting, the number of votes required for approval will depend on the nature of the proposal. Generally, under Texas and Virginia law and our bylaws, the number of votes required to approve a proposal is a majority of the shares of common stock present or represented by proxy and entitled to vote at the meeting. The proxy gives discretionary authority to the proxy holders to vote on any matter not included in this proxy statement that is properly presented to the shareholders at the meeting. The persons named as proxies on the proxy card are Robert W. Best, Executive Chairman, Charles K. Vaughan, Director and Lead Director and Nancy K. Quinn, Director and Chair of the Audit Committee.

CORPORATE GOVERNANCE AND OTHER BOARD MATTERS

Corporate Governance

In accordance with, and pursuant to, the corporate governance-related listing standards of the NYSE, the Board has adopted and periodically updated our Corporate Governance Guidelines ("Guidelines"), which govern the structure and proceedings of the Board and contain the Board's position on many governance issues. The Board has also adopted and periodically updated the Code of Conduct for our directors, officers and employees. The Code of Conduct provides guidance to the Board and management in areas of ethical business conduct and risk and provides guidance to employees and directors by helping them to recognize and deal with ethical issues including, but not limited to (i) conflicts of interest, (ii) gifts and entertainment, (iii) confidential information, (iv) fair dealing, (v) protection of corporate assets and (vi) compliance with rules and regulations. We have provided to our directors, officers and other employees a toll-free compliance hotline and a website by which they may report on an anonymous basis any observation of unethical behavior or suspected violation of our Code of Conduct. In addition, the Board has adopted and periodically updated the charters for each of its Audit, Human Resources and Nominating and Corporate Governance Committees. All of the foregoing documents are posted on the Corporate Governance page under the Investors tab of our website at *www.atmosenergy.com*.

Independence of Directors

The Board is comprised of a majority of independent directors in accordance with NYSE corporate governance-related listing standards. In accordance with rules of the SEC and the NYSE as well as our Guidelines, to be considered independent, a director must not have a direct or indirect material relationship with the Company or its management, other than as a director. To assist it in making its determination of the independence of each of its members, the Board has adopted its Categorical Standards of Director Independence ("Standards"). The Standards specify the criteria by which the independence of our directors will be determined and the types of relationships the Board has determined to be categorically immaterial, including relationships of directors and their immediate families with respect to past employment or affiliation with the Company, our management or our

independent registered public accounting firm. For purposes of the Standards, the Board has adopted the definition of an "immediate family member" as set forth by the NYSE, which includes a director's spouse, parents, children, siblings and in-laws of the director, as well as anyone else (other than domestic employees) who shares such director's home. The Standards and our Guidelines are posted on the Corporate Governance page of our website.

Based on its review of the Standards, as well as applicable SEC and NYSE rules, and taking into consideration all business relationships between the Company and each non-employee director and non-employee director nominee, the Board has concluded that none of such relationships are material other than the relationship with Mr. Springer described below. Accordingly, the Board has affirmatively determined that Ms. Quinn, Dr. Meredith and Messrs. Douglas, Esquivel, Gordon, Grable, Vaughan and Ware, as well as the non-employee directors who are continuing to serve the remainder of their terms, are independent members of the Board. In addition, the Board has affirmatively determined that each member of the Audit, Human Resources and Nominating and Corporate Governance Committees are independent under the Standards, as well as applicable SEC and NYSE rules.

In recommending to the Board that each non-employee director and nominee be found independent, the Nominating and Corporate Governance Committee reviewed and considered the following transactions, relationships or arrangements during the past three fiscal years, as discussed below. All matters described below fall within the Standards, including the monetary thresholds set forth in such Standards. Such matters are more fully discussed below under "*Related Person Transactions*."

- Mr. Ware is president of Amarillo National Bank in Amarillo, Texas, which provides a $25 million short-term line of credit to the Company and serves as a depository bank for us; and
- Several of our other directors either are natural gas customers or are affiliated with businesses that are natural gas customers of the Company in the ordinary course of business.

Because Mr. Springer's son-in-law is a partner with the firm of Ernst & Young, our independent registered public accounting firm, the Board has determined that Mr. Springer may not be considered independent from the Company under the Standards. However, Mr. Springer's son-in-law is not involved in our audit and is not considered a "covered person" with respect to us, as defined under the SEC's independence-related rules and regulations for auditors. Thus, this relationship has no effect on Ernst & Young's independence as our independent registered public accounting firm. Further, Mr. Springer does not serve on our Audit, Human Resources or Nominating and Corporate Governance Committees.

Related Person Transactions

In accordance with applicable SEC rules and in recognition that transactions into which we enter with related persons may present potential or actual conflicts of interest, our Board has adopted written guidelines with respect to related person transactions. For purposes of these guidelines, a reportable "related person transaction" is a transaction between the Company and any related person (i) involving more than $120,000 when aggregated with all similar transactions during any fiscal year and (ii) where such "related person" has or will have a direct or indirect material interest in such transaction (other than solely as a result of being a director or a less than 10 percent beneficial owner of another entity). A "related person" is any (a) person who is or was (since the beginning of the last fiscal year) an executive officer, director or nominee for election as a director of the Company; (b) person who

beneficially owns more than five percent of the Company's common stock or (c) immediate family member of any of the foregoing. An immediate family member includes a person's spouse, parents, children, siblings, in-laws and anyone residing in such person's home (other than domestic employees).

Under the guidelines, all executive officers, directors and director nominees are required to identify, to the best of their knowledge after reasonable inquiry, business and financial affiliations involving themselves or their immediate family members who could reasonably be expected to give rise to a related person transaction. Executive officers, directors and director nominees are required to advise the Corporate Secretary of the Company promptly of any change in the information provided and are asked periodically to review and reaffirm this information.

The Nominating and Corporate Governance Committee reviews the material facts of all related person transactions and either approves or disapproves of the entry into any such transaction. However, if advance committee approval of a related person transaction is not feasible, then it shall be considered and, if the committee determines it to be appropriate, ratified at the committee's next regularly scheduled meeting. In determining whether to approve or ratify a related person transaction, the committee takes into account, among other factors it deems appropriate, whether the related person transaction is on terms no less favorable than terms generally available to an unaffiliated third-party under the same or similar circumstances and the extent of the related person's interest in the transaction.

No director is allowed to participate in any discussion or approval of a related person transaction for which he or she is a related person, except that the director shall provide all material information concerning the transaction to the committee. If a related person transaction will be ongoing, the committee may establish guidelines for the Company's management to follow in its ongoing dealings with the related person. Thereafter, the committee, on at least an annual basis, shall review and assess ongoing relationships with the related person to see that they remain in compliance with the committee's related person transaction guidelines and that the related person transaction remains appropriate. In addition, the committee will periodically review the related person guidelines to determine if changes or modifications may be appropriate.

The committee also makes a recommendation to the Board as to whether the committee determines that an identified transaction is required to be reported as a related person transaction under SEC rules. Under SEC rules, certain transactions are deemed not to involve a material interest and thus, not reportable (including transactions in which the amount involved in any 12-month period is less than $120,000 and transactions with entities where a related person's interest is limited to service as a non-employee director). In determining materiality for this purpose, information is considered material if, in light of all the facts and circumstances of tbe transaction, there is a substantial likelihood a reasonable investor would consider the information important in deciding whether to buy, sell or vote shares of Company stock. The types of transactions specified below, which are pre-approved by the committee, are presumed not to be material.

- Transactions in the ordinary course of business with an entity for which a related person serves as an executive officer, provided (i) the affected director or executive officer does not participate in the decision on the part of the Company to enter into such transactions and (ii) the amount involved in any related category of transactions during any particular fiscal year is the lesser of (a) $1 million or (b) an amount which is less than one percent of the entity's gross revenue for the most recently completed fiscal year for which data is publicly available;

- Charitable gifts made in the ordinary course of business to a foundation, university or other nonprofit organization, provided (i) the affected director or executive officer does not participate in the decision on the part of the Company to make such gifts and (ii) the amount of gifts during any particular fiscal year is the lesser of (a) $120,000 or (b) an amount which is less than one percent of the nonprofit entity's gross revenue for the most recently completed fiscal year for which data is publicly available;
- Employment by the Company of a family member of an executive officer, provided the executive officer does not participate in decisions regarding the hiring, performance evaluation, or compensation of the family member; and
- Payments under the Company's employee benefit plans and other programs that are available generally to the Company's employees (including contributions under the Company's educational matching gift programs and payments to providers under the Company's health care plans).

The committee has reviewed the Company's ordinary course of business transactions during fiscal 2011 with companies for which related persons serve as executive officers and all other related person transactions, including the following transactions, which represent the only significant transactions of this type during fiscal 2011:

- As noted above, in the discussion on the independence of our directors, Mr. Ware is president of Amarillo National Bank in Amarillo, Texas, which provides a $25 million short-term line of credit to the Company and serves as a depository bank for us. In addition, from October 2010 through March 2011, Amarillo National Bank was the trustee for our 1998 Long-Term Incentive Plan ("LTIP"). During fiscal 2011, we paid a total of $287,674 to Amarillo National Bank for these services, which amount is reasonable and customary for these types of services and are substantially on the same terms as comparable third-party transactions. The committee has received written confirmation that such amount represents less than one percent of the gross revenues of the bank for the applicable period.
- Mr. Esquivel is Vice President for Community and Corporate Relations for UT Southwestern Medical Center in Dallas, Texas, which is a natural gas distribution customer of the Company in the ordinary course of business. For the 2011 fiscal year, the Company received total revenues from UT Southwestern Medical Center in the amount of $921,058. Our sales of natural gas to UT Southwestern Medical Center are made on substantially the same terms as other comparable third-party transactions. The committee has received written confirmation that such amount represents less than one percent of the gross revenues of UT Southwestern for the applicable period.

Accordingly, the committee has determined that none of those transactions involved a material interest. In addition, the Company is not aware of any related person transactions required to be reported under applicable SEC rules since the beginning of the last fiscal year where our policies and procedures did not require review or where such policies and procedures were not followed.

Board Leadership Structure

The Company's bylaws and Guidelines provide that our Board of Directors has the right to exercise its discretion to either separate or combine the offices of the Chairman of the Board and the Chief Executive Officer ("CEO"). This decision is based upon the Board's determination of what is in the best interests of the Company and its shareholders, in light of the circumstances and taking into consideration succession planning, skills and experience of the individuals filling those positions and

other relevant factors. Until October 1, 2010, the Board had historically determined that the offices of the Chairman of the Board and the CEO should be combined, primarily to provide unified leadership and direction for the Company. However, Mr. Best was appointed by the Board as Executive Chairman effective October 1, 2010, while Mr. Cocklin was appointed as President and CEO also effective October 1, 2010. Considering the skills and experience of Messrs. Best and Cocklin, the need to provide an orderly leadership transition from Mr. Best to Mr. Cocklin, and the completion of the execution of the Company's succession planning process, the Board determined that the Board and Company's leadership structure that is most appropriate is to have an Executive Chairman separate from its CEO. The current leadership structure is based on the experienced leadership provided by a full-time Executive Chairman (currently Mr. Best) and a full-time CEO (currently Mr. Cocklin), with both positions being subject to oversight and review by the Company's independent directors. The Board recognizes that if the circumstances change in the future, other leadership structures might also be appropriate and it has the discretion to revisit this determination of the Company's leadership structure. A combined Chairman and CEO Board leadership structure has previously worked well for the Company and its shareholders and may do so in the future.

The Board's leadership structure is designed so that independent directors exercise oversight of the Company's management and key issues related to strategy and risk. Only independent directors serve on the Audit Committee, the Human Resources Committee and the Nominating and Corporate Governance Committee of the Board and all standing Board committees are chaired by independent directors. Additionally, independent directors regularly hold executive sessions of the Board outside the presence of the Executive Chairman, the President and CEO or any other Company employee and they generally meet in a private session with the Executive Chairman and the President and CEO at every regularly scheduled Board meeting.

Each year, the independent directors of the Board select an independent director to serve as a Lead Director (the "Lead Director"). The Lead Director performs the following duties: (i) convenes and chairs meetings of the non-management directors in executive sessions as may be necessary; (ii) coordinates and develops the agenda for executive sessions of the non-management directors; (iii) coordinates feedback to the Executive Chairman and the President and CEO on behalf of the non-management directors regarding business, management or other issues; (iv) collaborates with the Executive Chairman and the President and CEO in developing the agenda for meetings of the Board; (v) consults with the Executive Chairman and the President and CEO on related information that is sent to the Board; (vi) discusses the results of the performance evaluation of both the Executive Chairman and the President and CEO with the Chair of the Human Resources Committee; (vii) reports to the Executive Chairman and President and CEO the results of their respective performance evaluations and (viii) identifies and develops with the Executive Chairman and the President and CEO along with the Chair of the Nominating and Corporate Governance Committee, the Board's compositional needs and criteria for the selection of candidates to serve as directors. In performing the duties described above, the Lead Director is expected to consult with the chairs of the appropriate Board committees and solicit their participation. The Lead Director also performs such other duties as may be assigned to the Lead Director by the Board of Directors, the independent directors, the Executive Chairman or the President and CEO.

Risk Oversight Process

Our Board of Directors has the primary responsibility for risk oversight of the Company as a whole. However, the Board has delegated primary oversight responsibility to the Audit Committee.

The Audit Committee is responsible for overseeing risks associated with financial and accounting matters, including compliance with all legal and regulatory requirements and internal control over financial reporting. In addition, the Audit Committee has oversight responsibility for the Company's overall business risk management process, which includes the identification, assessment, mitigation and monitoring of key business risks on a company-wide basis. To assist the Audit Committee in performing this function, for the last several years, the Audit Committee has engaged the firm of KPMG LLP ("KPMG"), which also serves as the Company's internal auditor, to perform an annual enterprise risk assessment, upon which KPMG reports to the Audit Committee at its meeting each spring. For fiscal 2011, 14 key business risks were assessed by KPMG, including physical infrastructure, competition, transaction processing, business disruption, gas supply, credit, liquidity, regulatory and compliance. The Chairman of the Audit Committee then reports to the Board at its next meeting on such risk assessment and the overall effectiveness of the key business risk processes and controls. In addition, KPMG presents a report on its internal audit activities during the prior quarter to the Audit Committee at its regularly-scheduled quarterly meetings. The report includes the audit activities performed the previous quarter, which address the key business risks previously identified during the annual enterprise risk assessment, including evaluations and assessments of internal controls and procedures.

In addition, at each quarterly Audit Committee meeting, the Audit Committee reviews with management the steps taken by management to ensure compliance with established risk management policies and procedures relating to the Company's marketing and trading affiliate, Atmos Energy Marketing, LLC ("AEM"). Compliance with these risk management policies and procedures is monitored on a monthly basis by the AEM Risk Management Committee, which is comprised of officers of the Company and AEM along with other key employees. Such risk management policies and procedures address credit risk, liquidity risk, operational risk and legal/contract/regulatory risks. If appropriate, the Chairman of the Audit Committee then reports to the Board on any significant deviations from the risk management policies and procedures.

The Board has also charged the Human Resources Committee ("HR Committee") with ensuring that our executive compensation policies and practices support the retention and development of executive talent with the experience required to manage risks inherent to our business and do not encourage or reward excessive risk-taking by our executives. See the discussion in "*Compensation Risk Assessment*," beginning on page 12 for more information on the specific processes used by the HR Committee to assess the risk profile of our compensation program. The Nominating and Corporate Governance Committee oversees risks associated with corporate governance, including Board leadership structure, succession planning and other matters. The Board's role in risk oversight has had no significant effect on the Board's leadership structure. In addition, we believe that the current leadership structure of the Board supports effective oversight of the Company's risk management processes described above by providing independent leadership at the Board committee level, with ultimate oversight by the full Board as led by the Executive Chairman, the President and CEO and the Lead Director.

Lead Director and Communications with Directors

In accordance with the corporate governance-related listing standards of the NYSE, the independent directors of the Board have designated Charles K. Vaughan as the Lead Director at all meetings of non-management directors during fiscal 2012, which meetings will continue to be held by the Board on a regular basis. In addition, all independent members of tbe Board meet as a group at

least once annually. Shareholders and other interested parties may communicate with Mr. Vaughan, individual non-management directors, or the non-management directors as a group, by writing to Board of Directors, Atmos Energy Corporation, P.O. Box 650205, Dallas, Texas, 75265-0205 or by electronic mail at *boardofdirectors@atmosenergy.com*. Our Senior Vice President and General Counsel, Louis P. Gregory, receives all such communications initially and forwards the communications to Mr. Vaughan or another individual non-management director, if applicable, as he deems appropriate. Interested parties may also contact our directors who are members of management, Robert W. Best, Executive Chairman (*robert.best@atmosenergy.com*) and Kim R. Cocklin, President and CEO (*kim.cocklin@atmosenergy.com*); by mail at Atmos Energy Corporation, P.O. Box 650205, Dallas, Texas 75265-0205, or by telephone at 972-934-9227.

Committees of the Board of Directors

Standing Committees. We have certain standing committees, each of which is described below. The Executive Committee consists of the chairpersons of each of our standing committees and our Lead Director, Mr. Vaughan. Current members of the Executive Committee are Dr. Meredith, Ms. Quinn and Messrs. Gordon, Vaughan and Ware. Mr. Vaughan, as Lead Director, serves as chairman of the committee. In accordance with our bylaws, the Executive Committee has, and may exercise, all of the powers of the Board of Directors during the intervals between the Board's meetings, subject to certain limitations and restrictions as set forth in the bylaws or as may be established by resolution of the Board from time to time. The Executive Committee held no meetings during fiscal 2011.

The Board has established a separately-designated standing Audit Committee in accordance with applicable provisions of the Securities Exchange Act of 1934 ("Exchange Act"). The Audit Committee consists of Ms. Quinn, Dr. Meredith and Messrs. Esquivel, Grable and Ware. Ms. Quinn serves as chair of the committee. As discussed in "*Independence of Directors*," beginning on page 3, the Board has determined that each member of the committee satisfies the independence requirements of the NYSE and SEC. The Audit Committee oversees our accounting and financial reporting processes and procedures; reviews the scope and procedures of the internal audit function; appoints our independent registered public accounting firm and is responsible for the oversight of its work and the review of the results of its independent audits. The Audit Committee held five meetings during the last fiscal year and has adopted a charter that it follows in conducting its activities, which is available on the Corporate Governance page of our website.

The Human Resources Committee consists of Messrs. Douglas, Esquivel, Gordon and Grable. Mr. Gordon serves as chairman of the committee. As previously discussed, the Board has determined that each member of the committee satisfies the independence requirements of the NYSE and SEC. This committee reviews and makes recommendations to the Board regarding executive compensation policy and strategy and specific compensation recommendations for the CEO as well as our other officers and division presidents. This committee retained the worldwide consulting firm of Pay Governance LLC during fiscal 2011 to serve as its executive compensation consultant, which was directly accountable to the committee for the performance of its consulting services. In addition, the committee determines, develops and makes recommendations to the Board regarding severance agreements, succession planning and other related matters concerning our CEO as well as other officers and division presidents. This committee also administers our LTIP and Annual Incentive Plan for Management ("Incentive Plan"). During the last fiscal year, the committee held four meetings. The committee has adopted a charter that it follows in conducting its activities, which is available on the Corporate Governance page of our website.

The Nominating and Corporate Governance Committee consists of Ms. Quinn, Dr. Meredith and Messrs. Gordon and Ware. Mr. Ware serves as chairman of the committee. As previously discussed, the Board has determined that each member of the committee satisfies the independence requirements of the NYSE and SEC. This committee makes recommendations to the Board regarding the nominees for director to be submitted to our shareholders for election at each annual meeting of shareholders, selects candidates for consideration by the full Board to fill any vacancies on the Board, which may occur from time to time, and oversees all of our corporate governance matters. The committee held three meetings during the last fiscal year. The committee has adopted a charter that it follows in conducting its activities, which is available on the Corporate Governance page of our website.

The Work Session/Annual Meeting Committee consists of Dr. Meredith and Messrs. Douglas, Springer and Ware. Dr. Meredith serves as chairman of the committee. This committee selects the site and plans the meeting and agenda for the work session meeting of the Board held each year for the purpose of focusing on long-range planning and corporate strategy issues and selects the site for the annual meeting of shareholders. During the last fiscal year, the Work Session/Annual Meeting Committee held two meetings.

Other Board and Board Committee Matters

Human Resources Committee Interlocks and Insider Participation. As discussed above, the members of the HR Committee during the last fiscal year were Messrs. Douglas, Esquivel, Gordon and Grable. None of the committee members were, during fiscal 2011 or previously, an officer or employee of the Company or any of our subsidiaries. In addition, there were no interlocking relationships between any executive officer of the Company and any other corporation during fiscal 2011.

Attendance at Board Meetings. During fiscal 2011, our Board held 14 meetings and each director attended at least 75 percent of the aggregate of (a) all meetings of the Board and (b) all meetings of the committees of the Board on which such director served. We strongly support and encourage each member of our Board to attend our annual meeting of shareholders. However, on February 9, 2011, the date of our 2011 annual meeting of shareholders, only four of our directors were physically able to attend the annual meeting due to a major ice and snowstorm in the Dallas-Ft.Worth Metroplex on the day of the meeting.

Independence of Audit Committee Members, Financial Literacy and Audit Committee Financial Experts

In addition to being declared as independent under the NYSE listing standards, applicable NYSE and SEC rules and regulations require that each member of an audit committee satisfy additional independence and financial literacy requirements and at least one of these members must satisfy the additional requirement of having accounting or related financial management expertise. This additional requirement can be satisfied if the Board determines that at least one Audit Committee member is an "audit committee financial expert," within the meaning of applicable SEC rules and regulations. Generally, the additional independence requirements provide that (i) a member of the Audit Committee, or his or her immediate family members, are prohibited from receiving any direct or indirect compensation or fee from the Company or its affiliates and (ii) he or she may not be an affiliated person of the Company or any of its subsidiaries. An "immediate family member" is defined by applicable NYSE rules to include a director's spouse, parents, children, siblings and in-laws of the director, as well as anyone else (other than domestic employees) who shares the director's home.

Generally, the financial literacy requirements provide that the Board, in its business judgment, shall determine if each member is financially literate, taking into account factors such as the member's education, experience and ability to read and understand financial statements of public companies. Audit committee financial experts must have the following five additional attributes: (i) an understanding of generally accepted accounting principles and financial statements, (ii) the ability to assess the general application of such principles in connection with the accounting for estimates, accruals and reserves, (iii) experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the Company's financial statements, or experience actively supervising one or more persons engaged in such activities, (iv) an understanding of internal control over financial reporting and (v) an understanding of how an audit committee functions.

Based on its review of the independence, financial literacy and audit committee financial expert requirements previously discussed, as well as its review of their individual backgrounds and qualifications, the Board has determined that all members of the Audit Committee satisfy the additional independence and financial literacy requirements required by the SEC and NYSE for members of an audit committee. The Board has also designated Ms. Quinn and Mr. Ware each as an "audit committee financial expert," as such term is defined by applicable rules and regulations of the SEC. As provided by the safe harbor contained in applicable SEC rules and regulations, our audit committee financial experts will not be deemed "experts" for any purpose as a result of being so designated. In addition, such designation does not impose on such persons any duties, obligations or liabilities that are greater than the duties, obligations and liabilities imposed on such persons as members of the Audit Committee or the Board in the absence of such designation. This designation also does not affect the duties, obligations or liabilities of any other member of the Audit Committee or the Board.

Audit Committee Pre-Approval Policy

The Audit Committee has adopted a pre-approval policy relating to the provision of both audit and non-audit services by Ernst & Young. Our Audit Committee Pre-Approval Policy provides for the pre-approval of audit, audit-related, tax and other services specifically described in appendices to the policy on an annual basis. Such services are pre-approved up to a specified fee limit. All other permitted services, as well as proposed services exceeding the pre-approved fee limit, must be separately pre-approved by the Audit Committee. Requests for services that require separate approval by the Audit Committee must be submitted to the Audit Committee by both our Chief Financial Officer and our independent registered public accounting firm and must include a joint statement as to whether, in their view, the request is consistent with the SEC's rules on auditor independence. The policy authorizes the Audit Committee to delegate to one or more of its members pre-approval authority with respect to permitted services. The Audit Committee did not delegate any such pre-approval authority in fiscal 2011 and it pre-approved all audit, audit-related and tax fees for services performed by Ernst & Young in fiscal 2011 in accordance with such pre-approval policy. The Audit Committee further concluded that the provision of these services by Ernst & Young was compatible with maintaining its independence. The Audit Committee Pre-Approval Policy is available on the Corporate Governance page of our website.

Compensation Risk Assessment

The HR Committee has periodically engaged Pay Governance LLC, the executive compensation consulting firm ("Pay Governance"), which is the committee's independent executive compensation consultant, to assist the committee in assessing the risk profile of the compensation program of the Company. Pay Governance has reviewed all of the compensation arrangements of the Company to gauge whether any compensation arrangement encourages employees to engage in excessively risky behaviors detrimental to the Company and its shareholders. Our two annual incentive compensation plans are the Variable Pay Plan ("VPP") and the Incentive Plan. Pay Governance has also evaluated our long-term incentive plan, the LTIP, which includes grants of both time-lapse restricted share units ("RSU's") and performance-based RSU's. The review by Pay Governance of these incentive plans has included an evaluation of the plans' design features and provisions, including such provisions as the establishment of target levels, the determination of awards, the types of performance criteria measured, the capping of maximum award opportunities, the balance between annual and long-term opportunities, the role of the HR Committee in its governance and oversight and other issues. At the conclusion of its review and evaluation, Pay Governance has reported that the features shown below help to mitigate any excessive risk-taking on the part of the participants in these plans:

- Both the Incentive Plan and VPP annual plans place an appropriate cap on the size of any cash awards earned.
- Long-term incentives are granted each year to participants to appropriately balance short-term interests with long-term value creation.
- Fifty percent of the long-term awards are performance-based RSU's, which are tied to both three-year earnings per share ("EPS") performance and the return to shareholders (share price appreciation plus accrued dividends) for all participants, including our named executive officers.
- A key feature of the Incentive Plan that encourages long-term value creation is the plan's provision to allow for a premium value of voluntary conversion of annual cash awards, in 25 percent increments, to three-year time-lapse RSU's with a 50 percent premium value (20 percent beginning in fiscal 2012).
- Another key feature of the Incentive Plan that encourages long-term value creation is the plan's provision to allow for a premium value of voluntary conversion of annual cash awards, in 25 percent increments, to bonus stock with a 10 percent premium value (five percent beginning in fiscal 2012).
- Once the threshold levels are achieved, both the annual and long-term performance incentive plans use mathematical interpolation to calculate payouts between performance levels, thereby removing any payout cliffs or steep payout curves.
- The Company has a policy for the recoupment of executive compensation ("clawback policy") that provides for the repayment or forfeiture of any incentive awards earned due to fraud, misconduct or misstatement of financial results, described in "*Executive Compensation Recoupment Policy*," beginning on page 37.
- Key executives are subject to share ownership guidelines which encourage the executives to align their interests with the long-term interests of shareholders and all other constituents.

In addition, the HR Committee has periodically (i) reviewed the competitiveness of the compensation program for our affiliate, Atmos Energy Holdings, Inc. ("AEH"), (ii) assessed the alignment of the AEH compensation program with the risk profile of the trading/marketing company in

relation to the overall energy marketing and trading spectrum and (iii) approved enhancements to the compensation program that better align compensation with the Company's business strategy. Based on such review and evaluation, the HR Committee has determined that AEH's compensation program contains risks that are appropriate to the nature, size and scope of its operations. Accordingly, the HR Committee has determined that none of the plans comprising the compensation plans of either the Company or AEH encourage our executive officers or other employees to take excessive risks and that the risks arising from these plans are not reasonably likely to have a material adverse effect on the Company or AEH.

PROPOSAL ONE—ELECTION OF DIRECTORS

Background

Pursuant to an amendment to our Articles of Incorporation that was approved by our shareholders at our annual meeting of shareholders in February 2010, since February 2010, the Board of Directors has not been divided into three classes. Beginning with the 2011 annual meeting of shareholders, and at each annual meeting thereafter, all directors elected at the annual meeting have been and shall he elected for a one-year term expiring at the next annual meeting thereafter. However, this change to a declassified Board has not and will not affect the unexpired terms of directors elected prior to the change. The Board is nominating Ms. Quinn, Dr. Meredith and Messrs. Cocklin, Douglas, Esquivel, Gordon, Springer and Ware to continue serving as directors whose one-year terms will expire in 2013. Messrs. Cocklin, Douglas, Esquivel and Gordon were last elected to one-year terms by the shareholders at the 2011 annual meeting and Ms. Quinn, Dr. Meredith and Messrs. Springer and Ware were last elected to three-year terms by the shareholders at the 2009 annual meeting. All nominees were recommended for nomination by the Nominating and Corporate Governance Committee of the Board. We did not pay a fee to any third party to identify, evaluate or assist in identifying or evaluating potential nominees for the Board. In addition, the Nominating and Corporate Governance Committee did not receive any recommendations from a shareholder or a group of shareholders who, individually or in the aggregate, beneficially owned greater than five percent of our common stock for at least one year.

The other directors listed under "*Directors Continuing in Office*," beginning on page 19, will continue to serve in their positions for the remainder of their current terms. The names, ages, biographical summaries and qualifications of (i) the persons who have been nominated to serve as our directors are set forth under "*Nominees for Director*," beginning on page 15 and (ii) the directors who are continuing in office until the expiration of their terms are set forth in *"Directors Continuing in Office"* below. Each of the nominees has consented to be a nominee and to serve as a director if elected. If we receive proxies that are signed but do not specify how to vote, we will vote those shares FOR all of the nominees. To be elected as a director, our bylaws require a nominee to receive the vote of a majority of all outstanding shares of our common stock entitled to vote and represented in person or by proxy at a meeting of shareholders at which a quorum is present.

Procedures for Nomination of Candidates for Director

According to our hylaws, any shareholder may make nominations for the election of directors if notice of such nominations is delivered to, or mailed and received by the Corporate Secretary of the Company at our principal executive offices, not less than 60 days nor more than 85 days prior to the date of the originally scheduled meeting. However, if less than 75 days' notice or prior public

disclosure of the date of the meeting is given by the Company, notice of such nominations must be so received no later than the close of business on the 25th day following the earlier of the day on which notice of the meeting was sent or the day on which such public disclosure was made. Since we are providing less than 75 days' notice or prior public disclosure of the date of the 2012 annual meeting, shareholders may make nominations for the election of directors at the 2012 annual meeting, if notice of such nominations is delivered to, or mailed and received by the Corporate Secretary of the Company at our principal executive offices no later than the close of business on January 16, 2012, the 25th day following the day on which notice of the meeting is to be sent, Decemher 22, 2011. If no nominations are so made, only the nominations made by the Board of Directors may be voted upon at the 2012 annual meeting.

There are no differences in the manner in which the committee evaluates nominees for director based on whether or not the nominee is presented by a shareholder. All director candidates shall, at a minimum, possess the qualifications for director discussed below. Such notices should include the following: (i) name, address and number of shares owned by the nominating shareholder, (ii) the nominee's name and address, (iii) a listing of the nominee's background and qualifications, (iv) a description of all arrangements between such shareholder and each nominee and any other person and (v) all other information relating to such person that is required to be disclosed in the solicitations for proxies for election of directors under applicable SEC and NYSE rules and regulations. A signed statement from the nominee should accompany the notice of nomination indicating that he or she consents to being considered as a nominee and that, if nominated by the Board and elected by the shareholders, he or she will serve as a director.

Qualifications for Directors

The Nominating and Corporate Governance Committee uses a variety of methods to identify nominees for director, including considering potential director candidates who come to the committee's attention through current officers, directors, professional search firms, shareholders or other persons. Nominees for director must possess, at a minimum, the level of education, experience, sophistication and expertise required to perform the duties of a member of the board of directors of a public company of our size and scope. Once a person is nominated, the committee will assess the qualifications of the nominee, including an evaluation of his or her judgment and skills. The Board has adopted guidelines outlining the qualifications sought when considering non-employee director nominees, which are discussed in our Gnidelines posted on the Corporate Governance page of our website.

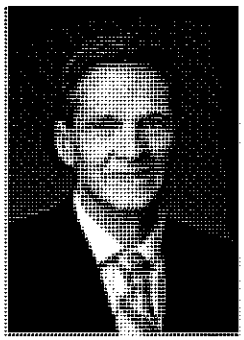
Based on the Guidelines, the specific qualifications and skills the Board seeks across its membership to achieve a balance of experiences important to the Company include, but are not limited to, outstanding achievement in personal careers; prior board experience; wisdom, integrity and ability to make independent, analytical inquiries; understanding of our business environment; and willingness to devote adequate time to Board duties. Other required specific qualifications and skills include a basic understanding of principal operational and financial objectives and plans and strategies of a corporation or organization of our stature; results of operations and financial condition of an organization and of any significant subsidiaries or business segments and a relative understanding of an organization and its business segments in relation to its competitors.

The Board is committed to diversified membership. The Board does not discriminate on the basis of race, color, national origin, gender, religion or disability in selecting nominees. Although the Board

has not established a formal policy on diversity, the Board and the committee believe it is important that our directors represent diverse viewpoints and backgrounds. Our Guidelines provide that the committee shall evaluate each director's continued service on the Board, at least annually, by considering the appropriate skills and characteristics of members of the Board of Directors in the context of the then current makeup of the Board. This assessment includes the following factors: diversity (including diversity of skills, background and experience); age; business or professional background; financial literacy and expertise; availability and commitment; independence and other criteria that the committee or the full Board finds to be relevant. It is also the practice of the committee to consider these factors when screening and evalnating candidates for nomination to the Board.

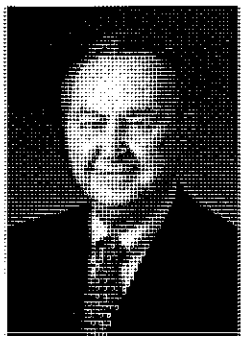
Nominees for Director

Each of the following eight current directors has been nominated to serve an additional one-year term on the Board of Directors with such term expiring in 2013.



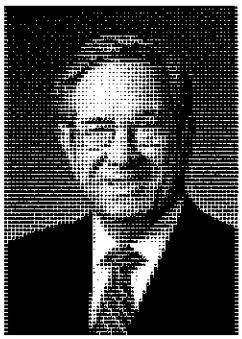
Kim R. Cocklin, President and Chief Executive Officer of Atmos Energy since October 2010; formerly President and Chief Operating Officer of Atmos Energy from October 2008 through September 2010 and Senior Vice President, Regulated Operations of Atmos Energy from June 2006 through September 2008; formerly Senior Vice President, General Counsel and Chief Compliance Officer of Piedmont Natural Gas Company in Charlotte, North Carolina from February 2003 through May 2006. Mr. Cocklin, 60, has been a director of Atmos Energy since 2009.

Mr. Cocklin was promoted to lead Atmos Energy as President and Chief Executive Officer in October 2010 and has been on the Company's senior management team since June 2006. Mr. Cocklin has over 30 years of experience in the natural gas industry, most of that serving in senior management positions at Atmos Energy, Piedmont Natural Gas Company and The Williams Companies. Mr. Cocklin has a strong background in the natural gas industry, including interstate pipeline companies, local distribution companies and gas treatment facilities. He also has extensive experience in rates and regulatory matters, business development and Sarbanes-Oxley compliance matters. Mr. Cocklin has held leadership roles within leading natural gas industry associations, including the Southern Gas Association and American Gas Association. As a result of such professional experience and leadership abilities, as well as possessing those attributes discussed in the "*Qualifications for Directors*" section above, the Board has nominated Mr. Cocklin to continue serving as a director of Atmos Energy.



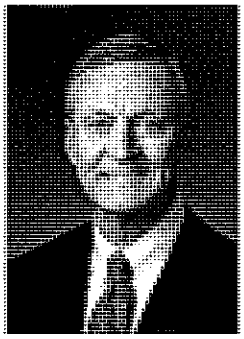
Richard W. Douglas, Executive Vice President for Jones Lang LaSalle LLC in Dallas, Texas since July 2008; formerly Executive Vice President with The Staubach Company in Dallas, Texas from October 2004 to July 2008, having served in numerous other executive officer positions with the Staubach Company from February 1999 to October 2004. Mr. Douglas, 64, has been a director of Atmos Energy since 2007.

Mr. Douglas gained leadership experience with Jones Lang LaSalle LLC, a global real estate management and investment firm and developed business and strategic planning expertise while at The Staubach Company, a nationally renowned real estate brokerage and services firm with international partnerships. Mr. Douglas also possesses outside board experience on numerous civic and nonprofit boards such as the United Way of Metropolitan Dallas. In addition, Mr. Douglas has experience as a leader in community organizations such as the Greater Dallas Chamber of Commerce. As a result of his professional experience and leadership abilities, as well as possessing those attributes discussed in the "*Qualifications for Directors*" section, the Board has nominated Mr. Douglas to continue serving as a director of Atmos Energy.



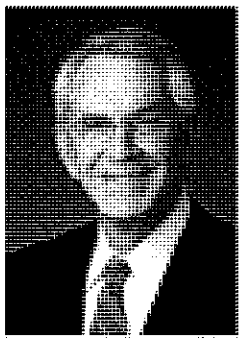
Ruben E. Esquivel, Vice President for Community and Corporate Relations for UT Southwestern Medical Center in Dallas, Texas since December 1995; formerly President and Chief Executive Officer of AVO International (formerly known as Multi-Amp Corporation). Mr. Esquivel, 68, has been a director of Atmos Energy since 2008.

Mr. Esquivel has led the community and corporate relations efforts for The University of Texas Southwestern Medical Center at Dallas, one of the nation's leading academic medical and research institutions, for the past 16 years. During his 34-year career with AVO International, Mr. Esquivel gained valuable leadership and managerial experience. Mr. Esquivel also has served as a leader on the boards of numerous publicly-held and non-profit organizations, including his past appointment as chairman of the Texas Guaranteed Student Loan Corporation, and chairman of several boards including the Dallas County Hospital District, North Texas Commission and YMCA of Metropolitan Dallas. As a result of his professional experience and leadership abilities, as well as possessing those attributes discussed in the "*Qualifications for Directors*" section, the Board has nominated Mr. Esquivel to continue serving as a director of Atmos Energy.



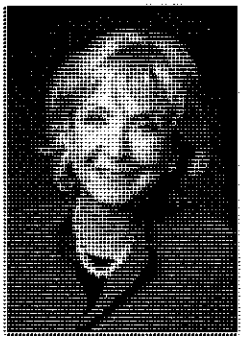
Richard K. Gordon, General Partner of Juniper Capital LP in Houston, Texas, since March 2003 and General Partner of Juniper Energy LP in Houston, Texas since August 2006; and formerly Vice Chairman Investment Banking for Merrill Lynch & Co. in Houston, Texas from October 1994 to February 2003. Mr. Gordon, 62, has been a director of Atmos Energy since 2001.

For both Juniper Capital LP and Juniper Energy LP, Mr. Gordon has been responsible for the past 10 years for managing a portfolio comprised of approximately $2 billion of power generation, mineral, oil and gas, natural gas gathering and oilfield services assets. Prior to working with Juniper Capital and Juniper Energy, Mr. Gordon spent 29 years working with such financial services firms as Dillon, Read & Co. Inc., The First Boston Corporation and Merrill Lynch & Co. At such firms, Mr. Gordon was responsible for investment banking activities related to energy and power companies, including natural gas distribution companies. Based on his extensive business experience, as well as possessing those attributes discussed in the "*Qualifications for Directors*" section, the Board has nominated Mr. Gordon to continue serving as a director of Atmos Energy.



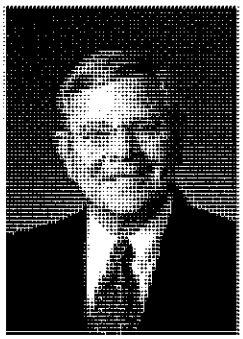
Thomas C. Meredith, Ed.D, President, Effective Leadership LLC from April 2009 to present; formerly Commissioner of Mississippi Institutions of Higher Learning in Jackson, Mississippi from October 2005 until November 2008; and Chancellor of the University System of Georgia in Atlanta, Georgia from January 2002 through September 2005. Dr. Meredith, 70, has been a director of Atmos Energy since 1995.

Dr. Meredith has exhibited leadership skills over the past 14 years as an administrative and financial consultant to university boards and presidents, Commissioner of Mississippi Institutions of Higher Learning, Chancellor of the University System of Georgia and Chancellor of the University of Alabama System. He also led an economic development task force for the State of Alabama, which led to the implementation of a major economic development plan for that state. Dr. Meredith is a recognized consultant in executive leadership and board development matters and he has experience in supervising executive level accounting staff, which has added to his financial and macroeconomic knowledge and related skills. As a result of his professional experience and leadership abilities, as well as possessing those attributes discussed in the "*Qualifications for Directors*" section, the Board has nominated Dr. Meredith to continue serving as a director of Atmos Energy.



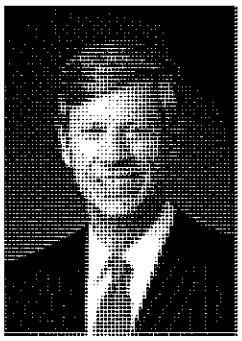
Nancy K. Quinn, Principal of Hanover Capital, LLC in East Hampton, New York since July 1996; currently a director of Endeavor International Corporation and Helix Energy Solutions Group, Inc. Ms. Quinn, 58, has been a director of Atmos Energy since 2004.

Hanover Capital, LLC, a privately-owned advisory firm, provides senior financial and strategic expertise, primarily to clients in the energy and natural resources industries. Prior to joining Hanover Capital, Ms. Quinn held a senior advisory role with the Beacon Group, focusing on energy industry private equity opportunities and merger and acquisition transactions. Ms. Quinn gained extensive experience in independent exploration and production, as well as in diversified natural gas and oilfield service sectors, while holding leadership positions at such firms as PaineWebber Incorporated and Kidder, Peabody & Co. Incorporated. Ms. Quinn has corporate governance leadership experience as chair of the audit committee of Endeavor International and has outside board experience as a member of the boards of Endeavour International and Helix Energy Solutions Group. Ms. Quinn was also previously a member of the boards of Louis Dreyfus Natural Gas and DeepTech International. As a result of her professional experience and leadership abilities, as well as possessing those attributes discussed in the "*Qualifications for Directors*" section, the Board has nominated Ms. Quinn to continue serving as a director of Atmos Energy.



Stephen R. Springer, Retired, formerly Senior Vice President and General Manager of the Midstream Division of The Williams Companies, Inc. in Tulsa, Oklahoma from January 1999 to February 2002; currently a director of DCP Midstream Partners, LP. Mr. Springer, 65, has been a director of Atmos Energy since 2005.

Mr. Springer's professional career includes 32 years in the regulated and nonregulated energy industry, while holding leadership roles at Texas Gas Transmission Corporation, Transco Energy Company and The Williams Company. Mr. Springer's vast knowledge of the natural gas industry includes natural gas transmission, marketing, supply, transportation, business development, distribution and gathering and processing segments of the industry. Mr. Springer also has outside board experience as a member of the boards of DCP Midstream Partners LP and the Indiana University Foundation. As a result of his professional experience and leadership abilities, as well as possessing those attributes discussed in the "*Qualifications for Directors*" section, the Board has nominated Mr. Springer to continue serving as a director of Atmos Energy.



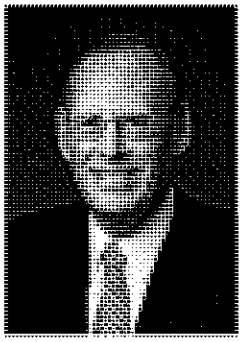
Richard Ware II, President of Amarillo National Bank in Amarillo, Texas since 1981. Mr. Ware, 65, has been a director of Atmos Energy since 1994.

Mr. Ware has developed substantial knowledge of the financial services industry during his 36-year career with a nationally recognized banking institution. Mr. Ware's strong background in assessing and overseeing complex financial matters, his leadership experience in supervising principal financial officers and his experience on the audit or finance committees of Atmos Energy, Southwest Coca Cola Bottling Company and the board of trustees of Southern Methodist University is a valuable asset to the Company. As a result of his professional experience and leadership abilities, as well as possessing those attributes discussed in the "*Qualifications for Directors*" section, the Board has nominated Mr. Ware to continue serving as a director of Atmos Energy.

THE BOARD OF DIRECTORS RECOMMENDS THAT SHAREHOLDERS VOTE "FOR" EACH OF THE ABOVE NOMINEES FOR DIRECTOR.

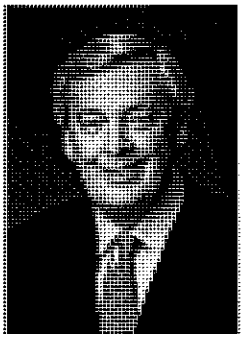
Directors Continuing in Office

The following directors will continue to serve until the expiration of their terms as noted below.



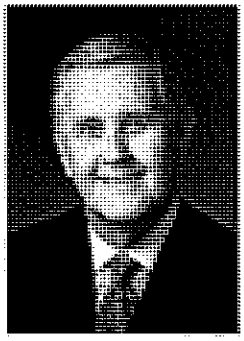
Robert W. Best, Executive Chairman of the Board of Atmos Energy since October 2010; formerly Chairman of the Board and Chief Executive Officer of Atmos Energy from October 2008 to September 2010 and Chairman of the Board, President and Chief Executive Officer from March 1997 to September 2008; currently a director of Associated Electric & Gas Insurance Limited. Mr. Best, 65, has been a director of Atmos Energy since 1997. *Term expires in 2013.*

Mr. Best led the senior management team of the country's largest natural gas-only distributor, Atmos Energy, from March 1997 until his retirement as Chief Executive Officer on September 30, 2010. Prior to joining Atmos Energy, Mr. Best had an extensive background in the natural gas industry, especially in the interstate pipeline, gas marketing and gas distribution segments of the industry, while serving in leadership roles at Consolidated Natural Gas Company, Transco Energy Company and Texas Gas Transmission Corporation during his 37-year career. Mr. Best also has outside board experience as a member of the boards of Maguire Energy Institute in the Cox School of Business at Southern Methodist University, Associated Electric & Gas Insurance Services Limited and the Gas Technology Institute, with leadership experience as chairman of the boards of Atmos Energy, American Gas Association, Southern Gas Association and Dallas Regional Chamber of Commerce. As a result of his professional experience and leadership abilities, as well as possessing those attributes discussed in the "*Qualifications for Directors*" section, the Board has determined that Mr. Best should serve as a director of Atmos Energy.



Robert C. Grable, Founding Partner, Kelly Hart & Hallman LLP, Fort Worth, Texas, since April 1979. Mr. Grable, 65, has been a director of Atmos Energy since 2009. *Term expires in 2013.*

Mr. Grable possesses advanced leadership skills developed as partner and one of seven founders of Kelly Hart & Hallman LLP, a large regional law firm. Mr. Grable has extensive experience in representing companies in the oil and gas industry, having represented oil and gas producers, pipelines and utilities in transactions, regulatory matters and litigation for over 31 years. Mr. Grable also has outside board experience as Trustee of the University of Texas Law Foundation and as an advisory board member for the local division of a global financial services firm. Mr. Grable is also a member of the McDonald Observatory and Astronomy Board of Visitors at the University of Texas at Austin. As a result of his professional experience and leadership abilities, as well as possessing those attributes discussed in the "*Qualifications for Directors*" section, the Board has determined that Mr. Grable should serve as a director of Atmos Energy.



Charles K. Vaughan, Retired, formerly Chairman of the Board of Atmos Energy from October 1983 until March 1997. Mr. Vaughan, 74, has been a director of Atmos Energy since 1983 and Lead Director of Atmos Energy since 2003. *Term expires in 2013.*

Mr. Vaughan has been involved in some capacity with Atmos Energy for over 54 years. His leadership experience as former Chairman, President and Chief Executive Officer of the Company, his vision for strategic development and his leadership in the successful implementation of multiple acquisitions for the Company have greatly contributed to the Company's success. Mr. Vaughan's outside board experience on the boards of Texas Gas Association, Southern Gas Association and American Gas Association and his affiliations in gas industry, business and community organizations have benefited not only the Company but the entire natural gas distribution industry. As a result of his professional experience and leadership abilities, as well as possessing those attributes discussed in the "*Qualifications for Directors*" section, the Board has determined that Mr. Vaughan should serve as a director of Atmos Energy.

DIRECTOR COMPENSATION

Annual Compensation

As compensation for serving as a director during fiscal 2011, each of our non-employee directors received an annual retainer of $75,000 payable in advance on a quarterly basis. Since June 1, 2007, our Lead Director, Mr. Vaughan, has received an annual fee of $25,000 for additional services he has performed in connection with being the Lead Director. Committee chairpersons are also paid an additional annual fee of $5,000 for additional services performed in connection with their committee duties and responsibilities.

The Company also provides our non-employee directors the option to receive all or part of their director fees (in 10 percent increments) in Atmos Energy common stock through the Atmos Energy

Corporation Outside Directors Stock-for-Fee Plan ("Stock-for-Fee Plan"). The purpose of this plan is to increase the proprietary interest of our non-employee directors in the Company's long-term prospects and the strategic growth of our business. The common stock portion of the payment of the fee earned in each quarter is issued as soon as possible following the first business day of each quarter. The number of shares issued is equal to the amount of the fee that would have been paid to the non-employee director during a quarter divided by the fair market value (mean of the highest and lowest prices as reported on the NYSE Consolidated Tape) on the first business day of such quarter. Only whole numbers of shares of common stock may be issued; fractional shares are paid in cash.

With respect to other director compensation matters, all directors are reimbursed for reasonable expenses incurred in connection with attendance at Board and committee meetings. A director who is also an officer or employee receives no compensation for his or her service as a director. We provide business travel accident insurance for non-employee directors and their spouses. The policy provides $100,000 coverage to directors and $50,000 coverage to their spouses per accident while traveling on Company business.

Long-Term Compensation

Each non-employee director participates in the Atmos Energy Corporation Equity Incentive and Deferred Compensation Plan for Non-Employee Directors ("Directors Plan"). This plan allows each such director to defer receipt of his or her annual retainer fee or other director fees and to invest such deferred fees in either a cash account or a stock account (in 10 percent increments). Each non-employee director also receives an annual grant of share units under the LTIP for each year he or she serves on the Company's Board of Directors. The grants occur on the 30th day following the Company's annual meeting of shareholders each plan year. The Directors Plan is intended to encourage qualified individuals to accept nominations as directors of the Company and to better align the interests between the non-employee directors and the Company's other shareholders.

The amount of the fee allocated as a credit to the cash account is converted to a cash balance as of the first business day of each quarter to be credited with interest at a rate equal to 2.5 percent plus the annual yield reported on a 10-year U.S. Treasury Note for the first business day of January for each plan year. The amount of the fee allocated as a credit to the stock account is converted to share units. The fee payable for the quarter is converted to a number of whole and, if applicable, fractional share units on the first business day of that quarter. Share units are also credited with dividend equivalents as and when dividends are declared on shares of the Company's common stock. Such dividend equivalent credits are converted to whole and, if applicable, fractional share units on the last business day of the month in which such dividends are paid. At the time of a participating director's retirement, plan benefits paid from the cash account are paid in the form of cash. Plan benefits paid from the stock account are paid in the form of shares of common stock equal in number to whole share units in the director's stock account. Any fractional share units are rounded up to a whole share unit prior to distribution.

Summary of Cash and Other Compensation

The following table sets forth all compensation paid to our non-employee directors for fiscal 2011.

Director Compensation for Fiscal Year 2011(a)

Name	Fees Earned or Paid in Cash ($)(b)	Stock Awards ($)(c)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)(d)	All Other Compensation ($)(e)	Total ($)
Richard W. Cardin	27,009	110,651	—	16,086	153,746
Richard W. Douglas	75,000	116,663	—	—	191,663
Ruben E. Esquivel	45,000	112,757	1,848	—	159,605
Richard K. Gordon	80,000	133,872	—	—	213,872
Robert C. Grable	52,571	131,479	—	—	184,050
Dr. Thomas C. Meredith	80,000	148,849	1,605	—	230,454
Phillip E. Nichol	27,009	150,558	—	19,252	196,819
Nancy K. Quinn	55,240	152,199	2	—	207,441
Stephen R. Springer	75,000	123,349	—	—	198,349
Charles K. Vaughan	105,000	162,397	—	—	267,397
Richard Ware II	24,294	200,957	—	—	225,251

(a) No options were awarded to our directors and no non-equity incentive plan compensation was earned by our directors in fiscal 2011.

(b) Non-employee directors may defer all or a part of their annual cash retainer under our Directors Plan. During fiscal 2011, $53,250 of the total amount payable for directors' fees was deferred, at the election of two of our directors, under our Directors Plan. Ms. Quinn and Mr. Esquivel elected to defer all or a portion of their director fees in fiscal 2011, as described in the table immediately below. Deferred amounts are invested, at the election of the participating director, either in a stock account or a cash account. Althongh Dr. Meredith did not participate in the deferred compensation feature of the Directors Plan in fiscal 2011, his accumulated balance associated with participation in previous years has continued to earn interest payable monthly.

(c) The amounts in this column reflect the fair value on the date of grant, calculated in accordance with FASB ASC Topic 718, of the share units awarded to our directors (except for Messrs. Cardin and Nichol) under our LTIP for service on our Board in fiscal 2011. The share units do not contain restrictions and are valued at $33.91 per share, which was the fair market value (mean of the highest and lowest prices as reported on the NYSE Consolidated Tape) on the date of grant on March 11, 2011. The amounts for Messrs. Cardin and Nichol were calculated as of the effective date of retirement, February 9, 2011, at the fair market value of $33.29.

The amounts described above also reflect the fair value of shares of stock issued under our Stock-for-Fee Plan to Messrs. Grable and Ware, who elected to receive all or a portion of their director's fees in the form of shares of stock in lieu of cash retainers for service on our Board in fiscal 2011. These shares also do not contain any restrictions. Shares are awarded on the first trading day of the quarter in which such fees were earned at the fair market value on that date. As a result, shares were issued to Messrs. Grable and Ware on the following dates and at the following values during fiscal 2011: (i) October 1, 2010, with a value of $29.33 per share; (ii) January 3, 2011, with a value of $31.50 per share; (iii) April 1, 2011, with a value of $34.45 per share and (iv) July 1, 2011, with a value of $33.57 per share.

(d) The amounts in this column represent the amount of above-market portion of interest earned during fiscal 2011 on the accumulated amount of Board fees deferred to cash accounts. Interest considered above-market is the incremental rate of interest earned above 120 percent of the 10-year U.S. Treasury Note rate, which is reset on January 1 each year.

(e) No director received perquisites and other personal benefits with an aggregate value equal to or exceeding $10,000 during fiscal 2011 other than Messrs. Cardin and Nicbol. These perquisites and other benefits were received primarily relating to retirement gifts and related items in recognition of their individual valued and lengthy service on the Board of Directors. Such perquisites and other benefits were valued at the aggregate incremental cost to the Company. Messrs. Cardin and Nichol served as directors during fiscal 2011 until their retirement on February 9, 2011, following our 2011 annual meeting of shareholders.

Director Deferred Board Fees

The following table sets forth, for each participating non-employee director, the amount of director compensation deferred during fiscal 2011 and cumulative deferred compensation as of September 30, 2011.

Director Deferred Board Fees for Fiscal Year 2011

Director	Board Fees Deferred to Stock Account ($)(a)	Dividend Equivalents Earned on Stock Account and Reinvested ($)(b)	Cumulative Board Fees Deferred to Stock Account at September 30 ($)	Board Fees Deferred to Cash Account ($)	Interest Earned on Cash Account ($)(c)	Cumulative Board Fees Deferred to Cash Account at September 30 ($)
Ruben E. Esquivel	—	—	—	30,000	5,995	116,394
Dr. Thomas C. Meredith	—	2,422	44,026	—	5,231	91,366
Nancy K. Quinn	23,250	2,316	59,409	—	7	120

(a) Ms. Quinn elected to receive 30 percent of her director fees in deferred stock. The $23,250 amount represents 721 share units received in fiscal 2011. Deferrals of amounts in the stock account are treated as though the deferred amounts are invested in our common stock at the fair market value of the shares on the date earned. Shares of our common stock equal to the number of share units in a director's stock account are issued to such director on the last day of the director's service or a later date selected by the director.

(b) Dividend equivalents earned on amounts of share units in the stock account are reinvested in additional share units based on the fair market value of the shares on the last trading day of each quarter. Such stock prices for fiscal 2011 were as follows: $31.33 on December 31, 2010, $34.00 on March 31, 2011, $33.22 on June 30, 2011 and $32.87 on September 30, 2011.

(c) The amounts in this column represent interest earned on accumulated amount of Board fees deferred to the cash account, during fiscal 2011, including deferrals made to the cash account in fiscal 2011, at a rate equal to the 10-year U.S. Treasury Note rate on the first day of each plan year (January 1) plus 250 basis points.

Director Share Units and Stock-for-Fee Awards

The following table sets forth the number of share units issued to our non-employee directors during fiscal 2011 for service on our Board or a Board committee and the number of share units earned as dividend equivalents during fiscal 2011 on the accumulated balances of share units for each director. The table also shows the amount of shares granted to directors in fiscal 2011 who elected to take all or a portion of their directors' fees in stock under our Stock-for-Fee Plan.

Director Share Units and Stock-for-Fee Awards for Fiscal Year 2011(a)

Director	Share Units Awarded(#)(b)	Share Units Earned as Dividend Equivalents(#)(c)	Shares Received as Stock-for-Fee Awards(#)(d)	Aggregate Grant Date Fair Value($)
Richard W. Cardin(e)	3,000	344	—	110,651
Richard W. Douglas	3,000	454	—	116,663
Ruben E. Esquivel	3,000	335	—	112,757
Richard K. Gordon	3,000	978	—	133,872
Robert C. Grable	3,000	222	699	131,479
Dr. Thomas C. Meredith	3,000	1,434	—	148,849
Phillip E. Nichol(f)	3,000	1,547	—	150,558
Nancy K. Quinn	3,721	835	—	152,199
Stephen R. Springer	3,000	658	—	123,349
Charles K. Vaughan	3,000	1,847	—	162,397
Richard Ware II	3,000	1,371	1,686	200,957

(a) All awards of share units under our LTIP vest immediately upon grant. Accordingly, no outstanding awards of share units are presented in this table.

(b) This amount represents annual grants of share units awarded to each non-employee director under our LTIP on the 30th calendar day following our annual meeting and the amount of share units held in a stock account which reflect the portion of director fees elected by the non-employee director for conversion to deferred share units as indicated above in the *"Director Deferred Board Fees for Fiscal Year 2011,"* table beginning on page 23. The share units are converted to common stock on a one-for-one basis at the time of retirement from our Board and directors have the option to take distribution in a single lump sum or in up to five annual installments.

(c) Share units earned as dividend equivalents are calculated based on the fair market value of the shares on the last trading day of each quarter. See footnote (b) to the *"Director Deferred Board Fees for Fiscal Year 2011"* table above.

(d) As discussed in footnote (c) to the *"Director Compensation for Fiscal Year 2011"* table on page 22, shares received as Stock-for-Fee awards are issued on the first trading day of the quarter in which they are earned and the number of shares awarded equals the amount of fees divided by the fair market value on that date. Only whole shares are issued; fractional shares are paid in cash.

(e) Upon his retirement from the Board of Directors, Mr. Cardin received a lump sum distribution of these shares, the total value of which was $1,166,948. The value was determined on February 9, 2011, based on the fair market value of the shares (mean of the highest and lowest prices as reported on the NYSE Consolidated Tape) of $33.29 per share.

(f) Upon his retirement from the Board of Directors, Mr. Nichol's equity incentive balance was 44,543 share units, which he elected to take in five annual installments. The first installment of 8,909 shares was issued on February 9, 2011, the total value of which was $296,581. The value was determined on February 9, 2011, based on the fair market value of the shares of $33.29 per share. Since the first distribution of 8,909 shares, Mr. Nichol's remaining equity incentive balance has accumulated quarterly dividend equivalents, bringing his aggregate share unit total to 36,735 share units.

BENEFICIAL OWNERSHIP OF COMMON STOCK

Security Ownership of Certain Beneficial Owners

The following table lists the beneficial ownership, as of December 1, 2011, with respect to each person known by us to be the beneficial owner of more than five percent of any class of our voting securities.

Title of Class	Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percent (%) of Class
Common stock	BlackRock, Inc.(a) 40 East 52nd Street New York, NY 10022	6,618,115	7.53(b)
Common stock	The Vanguard Group, Inc.(c) 100 Vanguard Blvd. Malvern, PA 19355	4,765,911	5.28(b)

(a) Based solely upon information contained in the most recently filed Schedule 13G/A with the SEC on February 2, 2011, which was filed by BlackRock, Inc. reflecting beneficial ownership of 6,618,115 shares of common stock as of December 31, 2010. According to this filing, BlackRock, Inc. possessed sole voting power over 6,618,115 of these shares with no shared voting power and sole dispositive power over 6,618,115 shares with no shared dispositive power. BlackRock, Inc. has not subsequently filed any Schedules 13G or amendments thereto with respect to its beneficial ownership of the Company's common stock.

(b) The percent of voting securities is based on the number of outstanding shares of our common stock as of December 1, 2011.

(c) Based solely upon information contained in the most recently filed Schedule 13G with the SEC on February 10, 2011, which was filed by The Vanguard Group, Inc. ("Vanguard") on behalf of its subsidiary, Vanguard Fiduciary Trust Company ("VFTC"), reflecting beneficial ownership of 60,726 shares by VFTC of the total of 4,765,911 shares of common stock as of December 31, 2010. According to this filing, Vanguard possessed sole voting power over 4,705,185 shares with no shared voting power and sole dispositive power over 4,705,185 shares with shared dispositive power with VFTC over 60,726 shares. In addition, VFTC possessed sole voting power over 60,726 shares with no shared voting power and no sole dispositive power with shared dispositive power with Vanguard over 60,726 shares. Vanguard has not subsequently filed any schedules 13G or amendments thereto with respect to its or its subsidiary's beneficial ownership of the Company's common stock.

Security Ownership of Management and Directors

The following table lists the beneficial ownership, as of December 1, 2011, of our common stock, the only class of securities issued and outstanding, with respect to all our directors and nominees for director, our chief executive officer, chief financial officer and our three other most highly compensated executive officers (our "named executive officers") and all our directors and named executive officers as a group. Except as otherwise noted, the directors, nominees and named executive officers, individually or as a group, have sole voting and investment power with respect to the shares listed.

Name of Beneficial Owner	Amount and Nature of Beneficial Ownership(#)	Percent (%) of Class(a)
Robert W. Best	620,682(b)	
Kim R. Cocklin	224,509	
Richard W. Douglas	14,182(c)	
Ruben E. Esquivel	10,090(c)	
Richard K. Gordon	35,018(c)	
Robert C. Grable	9,317(c)	
Louis P. Gregory	83,203	
Michael E. Haefner	57,316	
Fred E. Meisenheimer	87,309	
Dr. Thomas C. Meredith	47,798(c)	
Nancy K. Quinn	23,977(c)	
Stephen R. Springer	18,080(c)(d)	
Charles K. Vaughan	86,244(c)	
Richard Ware II	68,400(c)	
All directors, nominees and named executive officers as a group (14 individuals)(b)(c)(d)	1,386,125	1.53

(a) The percentage of shares beneficially owned by any individual does not exceed one percent of the class so owned.

(b) Includes 62,900 shares issuable upon the exercise of options held by Mr. Best under our LTIP within 60 days of December 1, 2011.

(c) Includes cumulative share units credited to the following directors under our Directors Plan and LTIP in the following respective amounts: Mr. Douglas, 12,037 units; Mr. Esquivel, 9,090 units; Mr. Gordon, 25,018 units; Mr. Grable, 6,293 units; Dr. Meredith, 36,340 units; Ms. Quinn, 21,977 units; Mr. Springer, 17,080 units; Mr. Vaughan, 46,535 units and Mr. Ware, 34,739 units.

(d) Includes 1,000 shares owned by Mr. Springer's spouse with whom voting and investment power are shared.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires our directors, executive officers and persons who beneficially own more than ten percent of our common stock to file with the SEC initial reports of ownership and reports of changes in their ownership in our common stock. Directors, certain executive officers and greater-than-ten-percent beneficial shareholders are required by SEC regulations to furnish us with copies of all Section 16(a) forms they file. Based solely on a review of the copies of such reports furnished to us, we believe that, during fiscal 2011, all of our directors, named executive officers and greater-than-ten-percent beneficial owners were in compliance with the Section 16(a) filing requirements.

HUMAN RESOURCES COMMITTEE REPORT

The Human Resources Committee of the Board of Directors has the responsibility for reviewing and recommending to the full Board of Directors, the Company's executive compensation program. The committee is composed entirely of persons who qualify as independent directors under the listing standards of the NYSE. In this context, the committee has met, reviewed and discussed with management the Compensation Discussion and Analysis contained in this proxy statement. Based on this review and discussion, the committee recommended to the Board of Directors, and the Board of Directors approved, the inclusion of the Compensation Discussion and Analysis in this proxy statement.

Respectfully submitted by the members of the Human Resources Committee of the Board of Directors:

Richard K. Gordon, Chairman
Richard W. Douglas
Ruben E. Esquivel
Robert C. Grable

COMPENSATION DISCUSSION AND ANALYSIS

Overview. In this section, we discuss our executive compensation objectives and strategy, the elements of compensation that we provide to our named executive officers, and the analysis we employed in reaching the decisions to pay the specific amounts and types of executive compensation discussed. Later, under "*Named Executive Officer Compensation*," beginning on page 39, we present a series of tables containing specific information about the compensation paid to or earned by our named executive officers during fiscal 2011, as well as more information about the elements of our executive officer compensation program. The discussion below is intended to assist you in understanding the information provided in the tables and in putting that information into context.

Executive Summary

Our executive compensation program is built upon the strategy of "Total Rewards," which we adopted for all employees in 1998. Under our Total Rewards strategy, we take a comprehensive view of the various compensation plans and employee benefits that comprise the total package of compensation that is offered to all our officers, including the named executive officers in this proxy statement, division presidents and other key employees. The Total Rewards strategy is based on the payment of (i) total cash compensation, composed of base salary and annual incentive compensation and (ii) total direct compensation, composed of total cash compensation and the annualized expected value of long-term incentive compensation awards, being targeted at the 50th percentile of all such compensation for equivalent positions at companies of comparable size in the natural gas distribution industry, which is represented by companies in our proxy peer group and in an energy services industry database, as discussed below. We believe this strategy also fosters a philosophy of "pay for performance" through the use of both annual and long-term incentive plans.

Our Total Rewards strategy, in which we limit the use of executive benefits and perquisites, is reviewed each year and updated as needed by our HR Committee with assistance from its independent executive compensation consultant. None of our employees, including our named executive officers,

have an employment agreement with the Company. Our executive compensation program does not permit or include problematic pay practices such as (i) the re-pricing of "underwater" stock options without shareholder approval, (ii) excessive perquisites or tax gross-up payments, or (iii) change in control severance payments that (a) exceed three times base salary and most recent bonus, (b) are triggered without an involuntary job loss or substantial diminution of duties ("single triggers") or (c) contain excise tax gross-up payments. We believe that our executive compensation program provides our executive officers with a balanced compensation approach each year by providing a reasonable base salary along with reasonable annual and long-term incentive compensation plans. These incentive plans are designed to reward our executive officers on both an annual and long-term basis if they attain specified target goals, the attainment of which do not require the taking of an unreasonable amount of risk, as discussed in "*Compensation Risk Assessment*," beginning on page 12.

Overview of Annual Incentive Compensation Paid for Fiscal 2011 Financial Performance. The Company achieved its budgeted EPS goal of $2.27 per diluted share in fiscal 2011, representing a 3.2 percent increase over fiscal 2010. The Company's target EPS amount under the Incentive Plan was also $2.27 for fiscal 2011. Because the Company actually earned an EPS of $2.27, this performance attainment resulted in the named executive officers, and the other participants in the Incentive Plan, receiving awards equal to 100 percent of their respective target awards (as a specified percentage of base salary). See "*Annual Incentive Compensation*," beginning on page 30.

Overview of Long-Term Incentive Compensation Paid for Fiscal 2009-2011 Financial Performance. The Company achieved a cumulative EPS amount of $6.54, compared to the cumulative EPS target amount of $6.63 during the three-year performance period ended September 30, 2011 (fiscal 2009-2011), for the grants of performance-based RSU's awarded in May 2009. The participants, including the named executive officers, earned a total number of performance-based RSU's equal to approximately 80 percent of the target plus dividend equivalents, in the form of shares of common stock issued in November 2011. See *"Long-Term Incentive Compensation,"* beginning on page 32.

Recently Adopted Changes in Executive Compensation. During the last couple of fiscal years, the HR Committee, along with its current executive compensation consultant, Pay Governance LLC, with the assistance of its former executive compensation consultant, Towers Watson, have completed periodic reviews of the Company's overall approach to executive benefits and perquisites, to ensure that the Company's current benefits, perquisites, policies and practices have continued to be in line with best practices of other companies in the natural gas distribution industry as well as other Fortune 500 companies. As a result of those reviews, the HR Committee has approved several changes to the Company's benefits, perquisites, policies and practices that have maintained the alignment of the Company's executive compensation plans with best practices utilized by other companies in our industry peer group as well as by other Fortune 500 companies in general and have reduced the overall cost of executive compensation for all of the Company's officers and division presidents. These changes, which were all approved by our Board of Directors, include those specifically discussed below:

- Beginning in fiscal 2012, when participants in the Incentive Plan elect to convert all or a portion of their incentive payments to time-lapse RSU's or shares of bonus stock prior to the beginning of each fiscal year, the premium in value they will receive for the conversion to RSU's will be reduced from 50 percent to 20 percent of the value at the date of grant, while the premium received for shares of bonus stock will be reduced from 10 percent to five percent;

- Beginning in fiscal 2012, the performance targets and actual performance attainment for both the Incentive Plan and performance-based RSU's granted under the LTIP will exclude any mark-to-market gains or losses recognized by the Company's nonregulated operations. See the discussion under "*Annual Incentive Compensation*," beginning on page 30 and "*Long-Term Incentive Compensation*," beginning on page 32;
- Beginning in fiscal 2011, adoption of a clawback policy, known as the Executive Compensation Recoupment Policy, which provides for the recoupment by the Company under certain circumstances of incentive compensation, including annual incentive awards, stock-based awards, performance-based compensation and any other forms of cash or equity compensation other than salary. See the discussion under "*Executive Compensation Recoupment Policy*," beginning on page 37;
- Beginning in fiscal 2011, adoption of a policy that prohibits hedging transactions in our common stock by any employee or director of Atmos Energy through the purchase of any financial instruments that establish a short position in our common stock and are designed to hedge or offset any decrease in the market value of our common stock. See the discussion under "*Policy Prohibiting Hedging-Related Transactions*" on page 38;
- Beginning in fiscal 2010, imposition of limits on the amount of awards earned as annual incentive compensation by our named executive officers with respect to the payouts under the Incentive Plan. If the total increase in the price of a share of Company common stock and the cumulative amount of dividends paid ("Total Shareholder Return" or "TSR") during the fiscal year is negative, the payout of the award for each named executive officer will be reduced to the amount awarded at the target level of the applicable incentive opportunity for each named executive officer, should the Company's performance exceed the performance target. See the discussion under "*Annual Incentive Compensation*," beginning on page 30;
- Beginning in fiscal 2010, any distributions of awards of performance-based RSU's that have been granted to our named executive officers under our LTIP shall be reduced to the amount awarded at the target level of performance, unless the Total Shareholder Return during the three-year performance period is positive. See "*1998 Long-Term Incentive Plan*," beginning on page 41;
- Beginning in fiscal 2010, elimination of payment by the Company to our named executive officers, in the event that excise taxes will be due on the payment of severance benefits to our named executive officers in the case of a change in control ("tax gross-up payment"). See the discussion under "*Change in Control Severance Benefits*" on page 34; and
- Beginning in fiscal 2010, enforcement of restriction period through the end of the relevant three-year restriction period on all equity grants under our LTIP for all recipients who have retired prior to the expiration of such restricted period.

Executive Compensation Objectives and Strategy

Our executive compensation program is designed to ensure that the interests of our executive officers are closely aligned with those of our shareholders and that our executive officers are paid an appropriate amount of incentive compensation only when the Company's performance warrants the payment of such compensation. At the same time, and in consideration of our ownership of regulated natural gas distribution properties and related nonregulated operations, our executive compensation plan considers the interests of both our regulated and nonregulated customers. We believe that our executive compensation program is effective in allowing the organization to attract and retain highly-qualified senior management who can deliver outstanding performance.

As discussed above, our executive compensation plan is built on the Total Rewards strategy and is founded upon the following principles:

- Our compensation strategy should be aligned with the overall business strategy of providing safe, quality service to our customers, seeking ongoing improvements in operating efficiencies and focusing upon growth opportunities in both our regulated and nonregulated operations.
- Overall pay targets should reflect the intent to pay executive base salaries at the 50th percentile of the competitive market practice with targeted total cash compensation and targeted total direct compensation to be paid at the 50th percentile of competitive market practice, if established performance targets are reached.
- Key executives charged with the responsibility for establishing and executing business strategy should have incentive compensation opportunities that are aligned with the creation of shareholder value and include upside potential with commensurate downside risk.
- Incentive compensation plans, to the extent practical and consistent with our overall corporate business strategy, should comply with Section 162(m) of the Internal Revenue Code (the "Code") so that full income tax deductions for executive compensation may be realized by the Company.
- Stock ownership is an important component of our executive compensation strategy and should closely align executives' interests with those of our shareholders. To facilitate stock ownership for executives, stock-based incentive plans should be utilized, along with share ownership guidelines.
- Our compensation strategy should have a limited emphasis upon perquisites and other personal benefits.

Elements of Executive Compensation

The following discussion describes the various elements of executive compensation that we have provided to our named executive officers, as well as a discussion of why we pay each element, how we determine the amount we pay under each element and how each element fits into our overall compensation objectives.

Base Salary. The amount of base salary paid to each named executive officer is a major determinant of the amounts of all other elements of compensation paid to our named executive officers. For example, the annual awards under the Incentive Plan are based on a percentage of base salary. See "*Annual Incentive Compensation*," beginning on page 30. In addition, the value of our long-term incentive compensation that the HR Committee has granted to our executive officers ranges from 100 percent to 150 percent of each named executive officer's midpoint of his respective salary range. See "*Long-Term Incentive Compensation*," beginning on page 32. Base salaries represent a small percentage of total compensation (approximately 20 percent in fiscal 2011). Positions are compared on the basis of job content to similar positions in companies in our proxy peer group and the energy services industry database. Salary ranges are reviewed on an annual basis and proposed salary ranges are reviewed and considered by the HR Committee in October of each year. The midpoint of each salary range is designed to approximate the 50th percentile of base salaries of such comparable companies. Our CEO provided the committee with an oral presentation discussing his individual performance and contributions, along with a performance evaluation of each named executive officer (other than himself and Mr. Best) that reflected individual goals and areas of accountability. Mr. Best also provided the committee with an oral presentation discussing his individual performance and contributions as Executive Chairman. Each named executive officer's final base salary for 2011 (fiscal

year 2011 for Messrs. Best and Cocklin and calendar year 2011 for the remainder of the named executive officers) was established by the committee after considering the competitive benchmarking data for each position, as discussed below, the committee's subjective evaluation of the performance of each named executive officer, the Company's overall salary increase budget and related salary increase guidelines established by the Company as well as current economic conditions. Generally, the base salary for each named executive officer, as finally determined by the committee for 2011, was established at or near the salary range midpoint for his pay grade, based upon the factors discussed above. In addition, in recognition of the beginning of the transition of duties and responsibilities from Mr. Best to Mr. Cocklin as chief executive officer of the Company, effective October 1, 2010, Mr. Best's base salary was decreased by 15 percent to $750,000 while Mr. Cocklin received a 35 percent increase in base salary to $750,000. In addition, the committee granted increases in base salaries to the remaining named executive officers in the following amounts, effective as of January 1, 2011: Mr. Meisenheimer, a six percent increase to $405,450; Mr. Gregory, a three percent increase to $334,180 and Mr. Haefner, a six percent increase to $310,050. The base salary increases were higher for Messrs. Meisenheimer and Haefner primarily because their base salaries were further below the midpoint of their salary ranges than the base salary of Mr. Gregory. The committee believes that the base salaries as finally determined for each of the named executive officers were appropriate and competitive with salaries offered for similar positions by companies in our proxy peer group and the energy services industry database and are consistent with our Total Rewards strategy.

Annual Incentive Compensation. We believe it is important to provide our named executive officers with a reasonable financial incentive to maximize the Company's financial performance each year. Through our Incentive Plan, we provide our named executive officers, along with other officers, division presidents and other key management employees, an opportunity to earn an annual incentive award based upon the Company's actual financial performance each year. The Incentive Plan, which has been designed to comply with Section 162(m) of the Code, is based on our ability to achieve a target level of EPS each year. The EPS performance measurement is the lynchpin of both our short-term (annual) and long-term compensation plans. The HR Committee believes that EPS is the most appropriate measurement of our financial performance both on an annual and long-term basis, because it reflects the growth of both our regulated and nonregulated operations. EPS is also one of the most well-known measurements of overall financial performance, which is widely used by financial analysts as well as the investing public. The committee believes that using this measurement as the basis for our incentive compensation plans aligns the interests of the participants in the Incentive Plan and the LTIP, including our named executive officers, with the interests of our shareholders.

For fiscal 2011, the HR Committee reviewed competitive compensation benchmarking data, as discussed below, to establish an annual target opportunity expressed as a percentage of salary earned for the fiscal year for each participant in the Incentive Plan. The committee has historically used varying percentages for annual target incentive award opportunities for all participants in the Incentive Plan, based on each participant's particular pay grade, which range from Grades 11-14 for our named executive officers. Our pay grades are based on competitive market data, as well as the job content and responsibility of each participant, and the potential impact that each participant could have on the operations and financial performance of the Company. The target incentive award opportunities for each participant are reviewed each year and benchmarked against the 50th percentile as described above.

The Incentive Plan targets for fiscal 2011 for each of the named executive officers were as follows:

Name	Fiscal Year 2011 Incentive Plan Target as Percent (%) of Salary Earned
Robert W. Best	80
Kim R. Cocklin	80
Fred E. Meisenheimer	60
Louis P. Gregory	55
Michael E. Haefner	55

At its meeting in October 2010, the HR Committee established the threshold, target and maximum performance levels of EPS presented below, upon which the Incentive Plan's awards would be based for fiscal 2011. The target EPS goal was based on our annual business plan and budget and took into account such factors in our regulated operations as the allowed rates of return in our established service areas, natural gas pricing and volatility, budgeted capital expenditures, expected growth within our service areas, competitive factors from other service providers and other business considerations embedded in the annual business planning process. The target EPS goal also took into account earnings expected from our nonregulated operations, including earnings from the provision of natural gas management and marketing services to municipalities, other local gas distribution companies and industrial customers as well as the provision of natural gas transportation and storage services to certain of our natural gas distribution divisions and third parties.

The Company's target level of EPS was $2.27 for fiscal 2011 and the HR Committee adopted this level as the Incentive Plan's target goal. A threshold level of performance was established at an EPS amount of $2.02. If we had earned an EPS less than $2.02, no awards would have been paid to any participant under the Incentive Plan. For fiscal 2011, we earned an EPS of $2.27. This performance attainment resulted in the named executive officers, and the other participants in the Incentive Plan, receiving awards equal to 100 percent of their respective target awards (as a specified percentage of salary earned for the fiscal year). The maximum payout opportunity under the Incentive Plan would have resulted in our named executive officers receiving an award equal to 200 percent of their target award, or a total of 110 percent to 160 percent of each of their respective salaries earned for the fiscal year, depending on each officer's pay grade. To achieve a maximum award under the Incentive Plan, we would have had to earn an equivalent of $2.53 in EPS. The HR Committee has the discretion under the Incentive Plan to make downward adjustments to earned awards but may not make upward adjustments. For fiscal 2011, the committee did not use its discretion to make negative adjustments to any awards for any participant in the Incentive Plan, including the named executive officers. However, the committee had previously decided to place a limit under certain conditions on the amount of earned awards for all members of the Management Committee, which is composed of all our named executive officers, beginning in fiscal 2010. If the Total Shareholder Return during any fiscal year is negative, the earned award for each such officer for that fiscal year will be limited to the amount earned at the target level of performance. This limitation was not operative in fiscal 2011 both because compensation was paid at the target level of performance, as discussed above and the Total Shareholder Return was positive for the fiscal year at 16.6 percent.

For two of the last three fiscal years prior to fiscal 2011, we either reached or exceeded our target level of performance based on EPS, with the payouts to participants averaging approximately 107

percent of their target awards each year. Our EPS target levels under the plan have historically increased between 4 and 6 percent each year and typically have been within the range of announced EPS guidance provided to the public in October or November of each year. The following table summarizes the performance targets and actual performance attainment for the Incentive Plan for fiscal 2011:

Performances	Company EPS Performance	Percent (%) of Target Award Earned
Below Threshold	Less than $2.02	No award
Threshold	$2.02	50
Actual EPS Earned	$2.27	100
Target	$2.27	100
Maximum	$2.53	200

As discussed above in "*Recently Adopted Changes in Executive Compensation*", beginning in fiscal 2012, the performance targets and actual performance attainment for the Incentive Plan will exclude any mark-to-market gains or losses recognized by the Company's nonregulated operations. This change was made in an effort to remove the impact of such gains or losses on earnings since they do not truly reflect the operating performance of the Company.

Long–Term Incentive Compensation. From fiscal 2004 through fiscal 2008, we used time-lapse shares of restricted stock with a three-year cliff vesting period and performance-based RSU's that were subject to a three-year performance criteria expressed as a cumulative EPS target amount, as our two forms of long-term incentive compensation under our LTIP. See "*1998 Long-Term Incentive Plan,*" beginning on page 41 for further information about the LTIP. In May 2009, the HR Committee began its current program of awarding grants that are structured with 50 percent of the targeted long-term value in the form of time-lapse RSU's with three-year cliff vesting (as distinct from shares) with the remaining 50 percent in the form of performance-based RSU's. The committee decided to grant time-lapse RSU's (as distinct from shares) primarily because their terms are more aligned with the terms of the performance-based RSU's. Typically, the value of the long-term compensation that the committee grants has ranged from 100 percent to 150 percent of each named executive officer's midpoint of his respective salary range. All such grants in fiscal 2011 fell within that range for all named executive officers. We based the actual number and value of awards granted on the competitive compensation benchmarking of grants made by the companies in our proxy peer group and the energy services industry database, as discussed below.

The HR Committee believes that the payment of long-term incentive compensation in the form of grants of time-lapse RSU's promotes and encourages long-term retention and service to the Company and better aligns the interests of our named executive officers with those of our shareholders through increased share ownership. The committee also believes that an equal amount of grants of performance-based RSU's, as measured by cumulative EPS over a three-year performance period, provide a balanced approach to long-term compensation by rewarding our named executive officers for improved financial performance of the Company, thereby giving them an incentive to enhance long-term shareholder value. Finally, the committee believes this approach should also better align the interests of our named executive officers with those of our shareholders through promoting improved financial performance of the Company, increased shareholder value and increased share ownership.

With respect to the Company's actual performance during the three-year performance period ended September 30, 2011, for the grants of performance-based RSU's awarded in May 2009 for the

fiscal 2009-2011 performance period, the Company achieved a cumulative EPS amount of $6.54, compared to the cumulative EPS target amount of $6.63. Since the performance level attained was between threshold and target, straight-line interpolation was used to compute the actual number of performance-based RSU's earned. Therefore, the participants, including the named executive officers, earned a total number of performance-based RSU's equal to approximately 80 percent of the target plus dividend equivalents, in the form of shares of common stock issued in November 2011. Note that the TSR limitations on the payout of the grants of performance-based RSU's will be operative beginning for the fiscal 2010-2012 performance period.

The committee also awarded grants of new performance-based RSU's in May 2011 for the fiscal 2011-2013 performance period. The following table shows the three-year performance criteria for fiscal 2011-2013:

Performance-Based Restricted Stock Units Grants in May 2011
Fiscal Years 2011-2013 Cumulative EPS Targets

	Below Threshold	Threshold	Target	Maximum
Three-Year Cumulative EPS	<$6.90	$6.90	$7.15	$7.40
Percent of Award Earned	None	50%	100%	150%

As discussed above in "*Recently Adopted Changes in Executive Compensation*," beginning on page 27, beginning in fiscal 2012, like under the Incentive Plan, the performance targets and actual performance attainment for any performance-based RSU's granted under the LTIP will exclude any mark-to-market gains or losses recognized by the Company's nonregulated operations. This same change was made in an effort to remove the impact of such gains or losses on earnings over the three year performance period since they do not truly reflect the operating performance of the Company over such period.

Retirement Benefits. Our Pension Account Plan ("PAP") serves as the foundation of retirement benefits for our named executive officers. It is a qualified, cash balance defined benefit pension plan. Benefits under this plan become vested and non-forfeitable after completion of three years of continuous employment. For any named executive officer who retires with vested benefits under the plan, the compensation shown as "Salary" in the "*Summary Compensation Table for Fiscal Year 2011*," beginning on page 39 would be considered eligible compensation in determining benefits.

Our named executive officers (as well as most of our other officers, division presidents and other employees designated by the Board) also participate in one of two supplemental retirement plans, which provide retirement benefits (as well as supplemental disability and death benefits). Each participant in these supplemental plans who bas been a participant for at least two years and has attained age 55 is entitled to an annual supplemental pension in an amount that, when added to his or her annual pension payable under the PAP, equals 60 percent of his compensation, which will be generally equal to the sum of the amount of the participant's last annual base salary and the amount of his or her last award under the Incentive Plan (75 percent of compensation in the case of Mr. Best), subject to reductions for less than ten years of employment with the Company and for retirement prior to age 62 (the "60% SERP"). In addition, should the Board appoint any officers to the Company's Management Committee in the future, such officer will also participate in the 60% SERP. However, all other officers who have been appointed by the Board on or after August 5, 2009 instead participate in a supplemental account balance retirement plan that provides retirement benefits to the participants. The HR Committee believes that these retirement benefits at the amounts provided are an important

component of the total compensation and benefits that we provide under our Total Rewards strategy and are required to ensure that our overall executive compensation package remains competitive with packages offered by other major public companies in our industry. See the discussion under "*Retirement Plans*," beginning on page 46 for more information on our retirement benefits.

Change in Control Severance Benefits. We have entered into severance agreements with each of the named executive officers to provide certain severance benefits for them in the event of the termination of their employment within three years following a "change in control" of the Company (as defined in the severance agreements and described generally in "*Change in Control Severance Agreements*," beginning on page 48). The severance agreement for each named executive officer generally provides that the Company will pay such officer as severance pay in one lump sum an amount equal to (a) 2.5 times his total compensation (annual base salary and the higher of the last payment or the average of the three highest payments received nnder the Incentive Plan) and (b) the total of (i) an amount that is actuarially equivalent to an additional three years of annual age and service credits payable to the officer under our PAP (ii) an amount that is actuarially equivalent to an additional three years of Company matching contributions payable to the officer under our RSP, (iii) an amount that is generally actuarially equivalent to an additional three years of health and welfare benefits and (iv) an amount actuarially equivalent to 36 months of accident and life insurance coverage, along with disability coverage. If such lump sum severance payment results in the imposition of excise taxes imposed by Section 4999 of the Code, the officer has the ability to elect to have the payment reduced to a level that will result in no payment of such excise tax. In lieu of reducing the severance payments under the agreement, each participant may elect to have the Company pay the full severance amount, thereby leaving the participant responsible for personally paying the excise tax penalties imposed for "excess parachute payments." The Board and the HR Committee modified the severance agreements for each of the named executive officers beginning in fiscal 2010 to this "best-net" approach, so that the Company would no longer he liable for tax gross-up payments on behalf of those individuals whose severance payments would have triggered excise tax penalties.

Additional Information on Executive Compensation

The compensation of our executive chairman, Mr. Best, and chief executive officer, Mr. Cocklin, were higher in fiscal 2011 than that of any of our other named executive officers, primarily in recognition of their levels of responsibility and the competitive market data for executive chairmen and chief executive officers of comparably sized companies in our proxy peer group and the energy services industry database. However, both Mr. Best and Mr. Cocklin participated in all the same compensation plans as the other officers and division presidents and were subject to the same performance measurement determinations under the incentive compensation plans. We do not have any individual compensation policies or plans that are not applied consistently to all of our officers and division presidents. We also do not have a policy under which the annual levels of compensation, and the grant of both Incentive Plan and LTIP awards, are adjusted each year to reflect the projected gains that may be realized by an executive officer from stock-based compensation. Each year, we set our target opportunities in incentive compensation based solely upon competitive market conditions and the other factors discussed below.

In addition, the HR Committee and our Board of Directors considered the results of our most recent shareholder advisory vote on executive compensation at our February 9, 2011 meeting of shareholders. Our shareholders overwhelmingly approved the compensation of our named executive officers for fiscal 2010, with over 96 percent of the shares voted in favor of such compensation.

Accordingly, our HR Committee and our Board decided to continue to adhere to its pay for performance philosophy and did not materially change our executive compensation decisions and policies over the last fiscal year. However, the HR Committee and Board will continue to review our executive compensation program in the future and will consider the views of our shareholders and other developments during such review.

Competitive Compensation Benchmarking

Like all major corporations, we operate in a competitive environment for talented executives. Pay Governance, the independent executive compensation consultant to the HR Committee, provided a comprehensive review of the compensation program elements and pay levels for companies similar to us and of comparable size as measured by financial measures and market capitalization for fiscal 2011. The competitive compensation benchmarking included assessments of all elements of compensation for our named executive officers, as well as the compensation program for the non-employee directors serving on the Board.

The competitive compensation benchmarking data reviewed by the HR Committee included base salary, annual incentive compensation and long-term incentive compensation found in the proxy statements filed by companies in the proxy peer group. This set of proxy peer group companies was also used to benchmark annual share utilization data, stock overhang and market capitalization data for long-term incentive compensation analysis. The companies in the proxy peer group were selected because they represent those companies considered by the committee to be the most comparable to the Company in terms of business operations, market capitalization and overall financial performance. The annual revenue for the companies in the proxy peer group ranged from $1.3 billion to $13.0 billion, with the average being $4.5 billion for the most recent year reported, while the Company reported revenue of $4.7 billion for the year ended September 30, 2010. The market capitalization for the companies in the proxy peer group ranged from $2.0 billion to $7.9 billion, with the average being $4.7 billion as of April 2011, while the market capitalization for the Company was $3.2 billion. The companies in the proxy peer group are selected annually by the committee, after its review of the recommendation of Pay Governance. The companies in the proxy peer group selected for the 2011 fiscal year were as follows:

AGL Resources Inc.	Nicor, Inc.
CenterPoint Energy Resources Corporation	NiSource, Inc.
CMS Energy Corporation	ONEOK, Inc.
EQT Corporation	Piedmont Natural Gas Company, Inc.
Intergys Energy Group, Inc.	Vectren Corporation
National Fuel Gas Corporation	WGL Holdings, Inc.

To supplement the executive compensation information derived from its study of the proxy peer group, the HR Committee also considered executive compensation benchmarking data from the latest Towers Watson U.S. CDB Energy Services Executive Compensation Database ("energy services industry database"). The companies in this database constitute a more diverse set of companies, including companies in the gas, nuclear and electric utilities industries. To adjust for size differences, Towers Watson employed a statistical analysis (single regression analysis) in the survey based on relative total annual revenues to determine competitive pay rates for our named executive officers based upon the data derived from all companies in the energy services industry database. The companies in this database are as follows:

AEI Services
Allegeheny Energy, Inc.
ALLETE, Inc.
Alliant Energy Corporation
Ameren Corporation
American Electric Power Company, Inc.
Areva
ATC Management, Inc.
Atmos Energy Corporation
Avista Corporation
BG US Services
Black Hills Power, Inc.
California Independent System Operator
Calpine Corporation
CenterPoint Energy Resources Corporation
CH Energy Group
Cleco Corporation
CMS Energy Corporation
Colorado Springs Utilities
Consolidated Edison, Inc.
Constellation Energy Group, Inc.
Covanta Holding Corporation
CPS Energy
DCP Midstream Partners, LP
Direct Energy
Dominion Resources, Inc.
DPL, Inc.
DTE Energy Company
Duke Energy Corporation
E.ON U.S.
Edison International
El Paso CGP Company
Electric Power Research Institute
Enbridge Energy Company, Inc.
Energen Corporation
Energy Future Holdings Corporation
Energy Northwest
Entergy Corporation
EPCO Holdings, Inc.
ERCOT
Exelon Corporation
First Solar, Inc.
FirstEnergy Corp.
FPL Group (Nextra Energy, Inc.)
GDF SUEZ Energy North America
Hawaiian Electric
IDACORP
Integrys Energy Group, Inc.
ISO New England
Kinder Morgan Kansas, Inc.
LES
Lower Colorado River Authority
MDU Resources Group, Inc.
Midwest Independent Transmission System Operator
Mirant Corporation
New York Independent System Operator
New York Power Authority
Nicor, Inc.
Northeast Utilities
NorthWestern Energy, LLC
NRG Energy, Inc.
NSTAR
NV Energy, Inc.
NW Natural
OGE Energy Corp.
Oglethorpe Power Corporation
Omaha Public Power
Pacific Gas and Electric Company
Pepco Holdings, Inc.
Pinnacle West Capital Corporation
PJM Interconnection
PNM Resources, Inc.
Portland General Electric
PPL Corporation
Progress Energy, Inc.
Proliance Holdings
Public Service Enterprise Group Incorporated
Puget Energy, Inc.
Regency Energy Partners LP
RRI Energy, Inc.
Salt River Project
Santee Cooper
SCANA Corporation
Sempra Energy
The Southern Company
Southern Maryland Electric Cooperative
Southern Union Company
Southwest Power Pool
Spectra Energy Corp.
STP Nuclear Operating
Targa Resources, Inc.
Tennessee Valley Authority
TransCanada Corporation
UIL Holdings Corporation
UniSource Energy Corporation
Unitil Corporation
Vectren Corporation
Westar Energy, Inc.
Westinghouse Electric Corp.
Wisconsin Energy Corporation
Wolf Creek Nuclear
Xcel Energy, Inc.

Using primarily the proxy peer group compensation analysis, along with the data from the energy services industry database, the targeted level of compensation for each named executive officer that represented the 50th percentile level for each position was determined. A named executive officer's base salary, total cash compensation (base salary plus annual incentive award) and total direct compensation (base salary plus annual incentive award plus annualized long-term incentive compensation) were considered competitive if his targeted level of compensation (for each element as well as total compensation) fell within 15 percent above or below the 50th percentile competitive benchmark amount. For fiscal 2011, the targeted level of compensation of each of our named executive officers fell within such range.

Executive Compensation Consultants

The HR Committee has been granted in its charter the sole authority from the Board of Directors for the appointment, compensation and oversight of the Company's outside compensation consultant. The committee retained Pay Governance during the 2011 fiscal year as its consultant to assist the committee with its responsibilities related to the Company's compensation program for its executives and board of directors. Specifically, the committee directed Pay Governance to (i) regularly attend meetings of the committee, (ii) conduct studies of competitive compensation practices and (iii) develop conclusions and recommendations related to the executive compensation plans of the Company for consideration by the committee. Pay Governance prepared reports and analyses and assisted with (i) the identification of the Company's proxy peer group, (ii) an assessment of competitive compensation for non-employee directors, and (iii) a review of base salary, annual incentives and long-term incentive compensation opportunities relative to competitive practices. Pay Governance also prepared a report on emerging trends and developments in executive compensation, provided recommendations regarding our executive compensation strategy and performed an assessment of the risks contained in the Company's incentive compensation plans. A senior consultant from Pay Governance attended all four HR Committee meetings held in fiscal 2011. Pay Governance provided no additional services to the Company or its affiliates during fiscal 2011.

Management's Role in Setting Executive Compensation

The HR Committee and Kim Cocklin, our Chief Executive Officer since October 1, 2010, met with representatives of Pay Governance at the beginning of fiscal 2011 to review and discuss the compensation of all other named executive officers. However, at no time did Mr. Cocklin meet with representatives of Pay Governance regarding his own compensation. The only other executive officer of the Company who regularly worked with Pay Governance is the senior vice president, human resources. For fiscal 2011, Mr. Cocklin recommended to the committee compensation for Messrs. Meisenheimer, Gregory and Haefner, while Pay Governance provided to the committee general guidance and competitive compensation data for Mr. Best.

Both Mr. Best and Mr. Cocklin may be present during a portion of the committee's meetings on executive compensation. However, Mr. Best and Mr. Cocklin and any other members of management in attendance at committee meetings are excused when that executive's compensation is discussed and decisions regarding his compensation are reached by the committee. Messrs. Best, Meisenheimer, Gregory and Haefner attend the committee's meetings except when compensation of the executive officers is discussed. All decisions by the committee concerning executive compensation levels to be paid to the CEO and the other named executive officers are approved by the Board.

Executive Compensation Recoupment Policy

In November 2010, our Board of Directors adopted our clawback policy, which provides for the recoupment by the Company under certain circumstances of incentive compensation, including annual cash bonuses, stock-based awards, performance-based compensation and any other forms of cash or equity compensation other than salary ("awards"). This policy applies to any current or former employee holding (or who held) a position of division president or corporate vice president or above. In the event of an accounting restatement of the Company's previously issued financial statements due to the material noncompliance of the Company with any financial reporting requirement under the federal securities laws, the Company will seek recovery from any current or former officer who received the amount or portion of any awards paid or granted during the three-year period preceding

the date on which the Company is required to prepare an accounting restatement, based on the erroneous data, in excess of what would have been paid or granted to the officer under the accounting restatement.

In addition, in the event of an accounting restatement as a result of errors, omission, fraud or other causes, the HR Committee shall review the facts and circumstances underlying the restatement (including any potential wrongdoing and whether the restatement was the result of negligence or intentional or gross misconduct) and may, in its discretion, direct that the Company recover all or a portion of any award from one or more officers with respect to any fiscal year in which the Company's financial results are negatively affected by such restatement. If (a) the payment, grant or vesting of any award(s) is based upon the achievement of financial results that are subsequently restated or (b) a lower payment, award value or vesting would have occurred based upon the restated financial results, the committee may seek to recoup, and such officer shall forfeit or repay, all or any portion of such excess compensation as the committee deems appropriate. Finally, if the committee determines that an officer engaged in an act of fraud or misconduct that contributed to the need for a financial restatement, the committee may, in its discretion, recover and the officer shall forfeit or repay, all of the officer's awards for the relevant period, plus a reasonable rate of interest. This policy, however, does not affect the Company's ability to recoup executive compensation under any other applicable law or regulation, including but not limited to the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

Policy Prohibiting Hedging-Related Transactions

Also in November 2010, our Board of Directors adopted a policy prohibiting hedging transactions in our common stock as an amendment to our insider trading policy, which provides that no employee of Atmos Energy or member of our Board of Directors may purchase any financial instruments (including, without limitation, prepaid variable forward contracts, equity swaps, collars and exchange funds) that establish a short position in our common stock and are designed to hedge or offset any decrease in the market value of our common stock granted by Atmos Energy as part of compensation to employees or directors or our common stock already held by them. In addition, the following transactions are prohibited: (i) "short sales," which are sales of our common stock that are not then owned, (ii) trading of put options, call options or other derivatives of our common stock and (iii) purchases of our common stock on margin, or holding our common stock in a margin account, borrowing against any account in which our common stock is held or otherwise pledging our common stock as collateral for a loan. However, any such arrangements already in existence as of November 3, 2010 have been allowed to continue, provided that the employee or director had disclosed the arrangement to the General Counsel or Corporate Secretary.

Share Ownership Guidelines

We have adopted share ownership guidelines for our named executive officers, and for other officers and division presidents, which are voluntary and are intended to be achieved by each such executive over the course of five years. The HR Committee believes that executive share ownership promotes better alignment of the interests of our executives with those of our shareholders and it monitors compliance with the ownership guidelines each year. The executive chairman and the chief executive officer each have a guideline to reach a share ownership position of five times his base salary, with each of the remaining named executive officers having a guideline to reach a share ownership position of 2.5 times base salary. The share ownership positions include shares of unvested time-lapse RSU's but do not include stock options or unvested performance-based RSU's. Each of the named executive officers has achieved his individual ownership objective.

NAMED EXECUTIVE OFFICER COMPENSATION

Summary of Cash and Other Compensation

The following table provides information concerning compensation we paid to or accrued on behalf of our Principal Executive Officer, our Principal Financial Officer and the three other most highly compensated executive officers serving as such on September 30, 2011.

Summary Compensation Table for Fiscal Year 2011(a)

Name and Principal Position	Year	Salary ($)	Stock Awards ($)(b)	Non-Equity Incentive Plan Compensation ($)(c)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)(d)	All Other Compensation ($)(e)	Total ($)
Robert W. Best(f)	2011	750,000	1,780,760	600,000	135,303	163,276	3,429,339
Executive Chairman of the	2010	875,372	1,577,951	706,152	197,486	168,529	3,525,490
Board	2009	848,844	1,655,960	657,000	3,549,649	202,323	6,913,776
Kim R. Cocklin(g)	2011	743,330	1,783,052	594,664	1,488,867	132,722	4,742,635
President and Chief	2010	552,692	916,414	362,253	783,815	155,888	2,771,062
Executive Officer	2009	537,328	2,258,079	337,000	705,159	202,833	4,040,399
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Louis P. Gregory	2011	331,372	484,868	182,255	588,707	71,230	1,658,432
Senior Vice President and	2010	321,757	410,744	178,445	329,305	66,941	1,307,192
General Counsel	2009	312,006	363,411	135,900	852,591	74,959	1,738,867
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

(a) No bonuses, as defined by applicable SEC rules and regulations, were paid or options awarded to any named executive officers in fiscal years 2011, 2010 or 2009.

(b) In accordance with applicable SEC rules, the valuation of stock awards in this table is based upon the grant date fair value of time-lapse restricted stock and time-lapse RSU's granted during fiscal 2009-2011 along with performance-based RSU's granted during fiscal 2009-2011 and excludes any estimate of forfeitures related to service vesting conditions. Note that due to a change in applicable SEC rules, the valuation of stock awards is no longer based on the compensation cost of awards recognized for financial statement purposes but instead are valued at the grant date fair value calculated in accordance with FASB ASC Topic 718. As a result, the amounts shown for fiscal 2009 have been changed to comply with the requirements of the new rules. The valuation also includes the fair value of the time-lapse RSU's converted from the portion of incentive compensation elected to be converted by the named executive officers in the prior fiscal year. In our financial statements, we use an estimated forfeiture rate of two percent (2%) of each grant (other than special one-time grants). The fair value of time-lapse-restricted stock, time-lapse RSU's and performance-based RSU's was determined based on the mean of the highest and lowest prices of our common stock on the grant date as reported on the NYSE Consolidated Tape, plus the value of the dividend equivalents for performance-based RSU's.

The fair value of the stock awards of restricted stock, RSU's and performance-based RSU's on the grant date are shown in the following table at their maximum value, assuming the highest level of performance conditions will be achieved during the performance period of the performance-based RSU's:

	Year	Stock Awards ($)
Robert W. Best	2011	2,671,451
	2010	1,973,666
	2009	2,066,759
Kim R. Cocklin	2011	2,673,743
	2010	1,114,271
	2009	2,463,478
Fred E. Meisenheimer	2011	981,406
	2010	722,766
	2009	690,855
Louis P. Gregory	2011	693,082
	2010	501,429
	2009	436,768
Michael E. Haefner	2011	684,300
	2010	493,733
	2009	—

(c) The amounts reflect the payments attributable to performance achieved at the level of 100 percent of target EPS in fiscal 2011 under our Incentive Plan. For a discussion of the performance criteria established by our HR Committee for awards in fiscal 2011 under our Incentive Plan, see "*Elements of Executive Compensation*," beginning on page 29. Awards under the Incentive Plan are paid in cash and are based on the participant's annual salary as of the grant date of the award. However, participants may elect prior to the beginning of each fiscal year to convert all or a portion of their awards either to bonus stock, with a premium equal to 10 percent of the total amount converted, or to time-lapse RSU's, with a premium equal to 50 percent of the amount converted, with such units being awarded under our LTIP. The amounts shown above do not include incentive compensation that was converted through an election by participating named executive officers prior to the beginning of fiscal 2011 to time-lapse RSU's, as shown in the table below. Such Incentive Plan payments include a premium of 50 percent of the value associated with the conversion in November 2011 to shares of time-lapse RSU's, which will be reflected in the Grants of Plan-Based Awards table for fiscal 2012. These units vest three years following the date of grant. The conversion elections are reflected in the table below.

	Incentive Plan Award ($)	Cash (%)	Amount ($)	Restricted Stock Units Elected (%)	Value of Restricted Stock Units ($)	Units (#)
Robert W. Best	600,000	—	—	100	900,000	25,648
Kim R. Cocklin	594,664	50	297,332	50	445,998	12,710
Fred E. Meisenheimer	239,298	—	—	100	358,947	10,229
Louis P. Gregory	182,255	—	—	100	273,382	7,791
Michael E. Haefner	167,743	—	—	100	251,614	7,171

Mr. Cocklin elected to convert to time-lapse RSU's 50 percent of his Incentive Plan payment attributable to fiscal 2011. Accordingly, in November 2011, Mr. Cocklin received 50 percent of his total Incentive Plan payment of $594,664 in cash or $297,332, while he received 50 percent in the form of time-lapse RSU's valued at $445,998 (reflecting a 50 percent premium on the remaining $297,332 of his total Incentive Plan payment). Such units were issued on November 8, 2011, based on the mean of the highest and lowest prices of our common stock that day, as reported on the NYSE Consolidated Tape, of $35.09 per share or 12,710 units. Messrs. Best, Meisenheimer, Gregory and Haefner elected to convert 100 percent of their respective Incentive Plan payments attributable to fiscal 2011 to time-lapse RSU's. Accordingly, in November 2011, Mr. Best received time-lapse RSU's valued at $900,000 or 25,648 units; Mr. Meisenheimer received time-lapse RSU's valued at $358,947 or 10,229 units, Mr. Gregory received time-lapse RSU's valued at $273,382 or 7,791 units and Mr. Haefner received time-lapse RSU's valued at $251,614 or 7,171 units (with all such grants reflecting a 50 percent premium). Each of such units was issued on November 8, 2011 also at $35.09 per share.

(d) The amounts reflect the aggregate current year increase in pension values for each named executive officer based on the change in the present value of the benefit as presented in the "*Pension Benefits for Fiscal Year 2011*" table on page 46. The present value is based on the earliest age for which an unreduced benefit is available and assumptions from the September 30, 2010 and September 30, 2011 measurement dates for our Pension Account Plan.

(e) The components of "All Other Compensation" are reflected in the table to follow.

(f) Mr. Best was appointed Executive Chairman of the Company, effective October 1, 2010.

(g) Mr. Cocklin was appointed President and CEO of the Company, effective October 1, 2010.

(h) Mr. Haefner joined the Company on June 2, 2008. However, he did not become one of the top three named executive officers other than the Principal Executive Officer or the Principal Financial Officer until October 1, 2009. Accordingly, no compensation information is presented for Mr. Haefner in fiscal 2009.

All Other Compensation for Fiscal Year 2011

Name	Company Contributions to Retirement Savings Plan ($)	Cost of Premiums for Company-Paid Term Life Insurance ($)	Dividends/ Dividend Equivalents Paid on Restricted Stock/Unit Awards ($)(a)	Financial Planning ($)(b)	Perquisites ($)(c)	Total ($)
Robert W. Best	9,800	1,938	145,853	5,685	—	163,276
Kim R. Cocklin	9,800	1,938	116,813	4,171	—	132,722
Fred E. Meisenheimer	9,800	1,938	68,854	2,000	—	82,592
Louis P. Gregory	9,800	1,835	57,595	2,000	—	71,230
Michael E. Haefner	9,800	1,689	41,765	2,000	—	55,254

(a) The amounts represent the dividends paid on unvested time-lapse restricted stock awards or dividend equivalents paid on time-lapse RSU's. Dividends are paid on shares of unvested restricted shares of common stock at the same rate as on non-restricted shares of common stock. Dividend equivalents are also paid on unvested time-lapse RSU's at the same rate as dividends on non-restricted shares of common stock.

(b) We provide financial planning services to our named executive officers, which benefit is valued at the actual charge for the services.

(c) No named executive officer received perquisites and other personal benefits with an aggregate value equal to or exceeding $10,000 during fiscal 2011.

1998 Long-Term Incentive Plan

To provide our named executive officers, other officers, division presidents and other key management employees with the incentive to achieve our long-term growth and profitability goals as well as to focus upon the creation of shareholder value, the HR Committee makes recommendations to the Board concerning grants of long-term incentive awards under our LTIP.

The HR Committee recommends all annual long-term incentive grants at its regularly scheduled March meeting, which are then approved by the Board at its regularly scheduled April or May meeting. In addition, when an award is granted in connection with a pre-established performance goal, the committee approves the performance goal and the related compensation formula within the first 90 days of the fiscal year. Each year, prior to making grants, the committee establishes a target long-term incentive value for the LTIP participants, including the named executive officers. The actual value of grants ultimately received by participants may differ from the intended value or target long-term incentive value granted, depending upon share price performance and any performance considerations imposed upon such awards.

No options have been granted to any participants since fiscal 2003 although they may still be granted under the terms of the LTIP. However, some participants did receive options in fiscal 2004 and 2005 pursuant to their election to convert all or a portion of their incentive compensation received under the Incentive Plan in those years, which election is no longer allowed under the Incentive Plan. Options may be exercisable in full at the time of grant or may become exercisable in one or more

installments. Options are exercisable for a period of ten years after the date of grant of the option. Since October 1, 2007, under the LTIP, at least 25 percent of the number of shares of common stock acquired through the exercise of any options granted after that date may not be sold or otherwise transferred by the participant for at least one year after the date of exercise. In the event of a participant's termination of service, the options lapse 90 days after said termination, except in the case of retirement, in which case the retiring participant may exercise the options at any time within three years from the date of retirement. In the event of death, the options may be exercised by the personal representative of the optionee at any time within three years from the date of death.

As discussed above, in "*Long-Term Incentive Compensation*," beginning on page 32, from fiscal 2004 through fiscal 2008, we used shares of time-lapse restricted stock and performance-based RSU's as our form of long-term incentive compensation. All restrictions lapse on time-lapse restricted stock at the conclusion of the third year following the date of grant, except for any grants that may be made by our Board in connection with the appointment of an officer. Dividends are paid on all time-lapse restricted stock after the date of grant during the period before the restrictions have lapsed at the same rate as other shares. Dividend equivalents are paid on the time-lapse RSU's at the same time and at the same rate as dividends are paid on time-lapse restricted stock and unrestricted shares of common stock. Once the restrictions have lapsed, the shares are issued to the participant by the Company, net of shares withheld for taxes, provided that he or she is an employee of the Company at that time.

Performance-based RSU's are subject to a three-year performance criterion expressed as a cumulative EPS target amount. The EPS target is derived from our annual business plan and represents the same EPS target at the time of grant as that used under the Incentive Plan; the EPS targets added to the Incentive Plan's target EPS for the second and third years have historically represented a growth in EPS of 4 percent to 6 percent each year, on average. At the conclusion of the three-year performance period, the total number of performance-based RSU's to be issued is determined by a formula with an established threshold, target and maximum number of RSU's earned, ranging from 0 percent to 150 percent of the performance-based RSU's granted, based on the cumulative amount of EPS achieved over the three-year performance period. Although our LTIP provides that cash, shares of our common stock or a combination thereof may be issued to participants in payment for their units, we have always paid participants for their units in the form of shares of our common stock at the end of each three-year performance period. In addition, dividend equivalents are credited to each participant's account with respect to the performance-based RSU's earned, with the payment of such dividend equivalents in the form of additional shares of stock not occurring until the three-year cumulative EPS performance targets are measured and vesting is completed. Beginning with grants made to our named executive officers during fiscal 2010, any distributions of awards of performance-based RSU's that have been granted to our named executive officers during fiscal 2010 or thereafter will be reduced to the amount awarded at the target level of performance, unless the Total Shareholder Return during the three-year performance period is positive. In addition, as discussed above under "*Long-Term Incentive Compensation*," beginning on page 32, beginning with grants in fiscal 2012, the performance targets and actual performance attainment for all performance-based RSU's granted under the LTIP will exclude any mark-to-market gains or losses recognized by the Company's nonregulated operations.

Grants of Plan-Based Awards

The following table shows the grants of executive compensation plan-based awards to the named executive officers during fiscal 2011.

Grants of Plan-Based Awards for Fiscal Year 2011(a)

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards(b) Threshold ($)	Target ($)	Maximum ($)	Estimated Future Payouts Under Equity Incentive Plan Awards(c) Threshold (#)	Target (#)	Maximum (#)	All Other Stock Awards: Number of Shares of Stock or Units (#)	Grant Date Fair Value of Stock and Option Awards ($)
Robert W. Best									
Incentive Plan	10/01/10	300,000	600,000	1,200,000	—	—	—	—	—
Restricted Stock Units	11/02/10	—	—	—	—	—	—	8,895	264,807(d)
Restricted Stock Units	05/03/11	—	—	—	—	—	—	23,100	801,801
PBR Stock Units	05/03/11	—	—	—	11,550	23,100	34,650	—	801,801
Kim R. Cocklin									
Incentive Plan	10/01/10	297,332	594,664	1,189,328	—	—	—	—	—
Restricted Stock Units	11/02/10	—	—	—	—	—	—	9,126	271,690(d)
Restricted Stock Units	05/03/11	—	—	—	—	—	—	23,100	801,801
PBR Stock Units	05/03/11	—	—	—	11,550	23,100	34,650	—	801,801
Fred E. Meisenheimer									
Incentive Plan	10/01/10	119,649	239,298	478,596	—	—	—	—	—
Restricted Stock Units	11/02/10	—	—	—	—	—	—	11,564	344,250(d)
Restricted Stock Units	05/03/11	—	—	—	—	—	—	7,750	269,003
PBR Stock Units	05/03/11	—	—	—	3,875	7,750	11,625	—	269,003
Louis P. Gregory									
Incentive Plan	10/01/10	92,784	182,255	364,509	—	—	—	—	—
Restricted Stock Units	11/02/10	—	—	—	—	—	—	8,991	267,688(d)
Restricted Stock Units	05/03/11	—	—	—	—	—	—	5,400	187,434
PBR Stock Units	05/03/11	—	—	—	2,700	5,400	8,100	—	187,434
Michael E. Haefner									
Incentive Plan	10/01/10	85,397	167,743	335,487	—	—	—	—	—
Restricted Stock Units	11/02/10	—	—	—	—	—	—	8,106	241,313(d)
Restricted Stock Units	05/03/11	—	—	—	—	—	—	5,400	187,434
PBR Stock Units	05/03/11	—	—	—	2,700	5,400	8,100	—	187,434

(a) No options were awarded to any named executive officer in fiscal 2011.

(b) The amounts reflect the estimated payments which could have been made under our Incentive Plan, based upon the participant's annual salary as of the date presented. The plan provides that our officers may receive annual cash incentive awards based on the performance and profitability of the Company. The HR Committee establishes annual target awards for each officer. The actual amounts earned by the named executive officers in fiscal 2011 under the plan are set forth under the "*Non-Equity Incentive Plan Compensation*" column in the "*Summary Compensation Table for Fiscal Year 2011*," beginning on page 39.

(c) The amounts reflect the performance-based RSU's granted under our LTIP, which vest three years from the beginning of the performance measurement period (October 1, 2010), at which time the holder is entitled to receive a percentage of the performance-based RSU's granted, based on our cumulative EPS performance over the period October 1, 2010 to September 30, 2013, payable in shares of our common stock including credited dividend equivalents. The grant date fair value on May 3, 2011 of $34.71, which is the mean of the highest and lowest prices of the stock on the date of grant, as reported on the NYSE Consolidated Tape, is reflected at the target level of performance.

(d) The amounts reflect the incentive compensation received under the Incentive Plan for fiscal 2010 attributable to conversions to shares of time-lapse RSU's issued under our LTIP. Such shares were granted at the fair market value of $29.77 on the date of grant on November 2, 2010. The grant date fair value is the value of the shares attributable to the original amount of incentive compensation converted plus the 50 percent value premium received in connection with such conversion.

Outstanding Equity Awards

The following table shows the outstanding equity awards held by the named executive officers at September 30, 2011.

Outstanding Equity Awards at Fiscal Year-End for 2011(a)

	Option Awards			Stock Awards			
Name	Number of Securities Underlying Unexercised Options Exercisable (#)	Option Exercise Price ($)	Option Expiration Date	Number of Shares of Stock or Units of Stock That Have Not Vested (#)(b)	Market Value of Shares of Stock or Units of Stock That Have Not Vested ($)(c)	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)(d)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested ($)(c)
Robert W. Best	62,900	$21.23	03/11/2013	105,795	3,433,048	47,100	1,528,395
Kim R. Cocklin	—	—	—	93,392	3,030,570	35,100	1,138,995
Fred E. Meisenheimer	—	—	—	53,503	1,736,172	15,750	511,088
Louis P. Gregory	—	—	—	42,924	1,392,884	10,900	353,705
Michael E. Haefner	—	—	—	30,222	980,704	10,900	353,705

(a) There were no securities underlying either unexercised options, which were unexercisable or unexercised unearned options granted under any equity incentive plan at the end of fiscal 2011. This table does not include amounts of time-lapse RSU's that were issued in November 2011 as a result of elections by the named executive officers to convert all or a portion of incentive compensation.

(b) Time-lapse restricted stock and time-lapse RSU's generally vest three years from the date of grant, as reflected in the next table.

(c) Market value is based on the closing price of our common stock of $32.45, as reported on the NYSE Consolidated Tape on September 30, 2011.

(d) See footnote (c) to the "*Grants of Plan-Based Awards for Fiscal Year 2011*" table, beginning on page 43 for a discussion of the vesting terms of our performance-based RSU's. Based on our projected performance at September 30, 2011, performance-based RSU's, at the target level of performance, will vest as indicated in the "*Performance-Based Restricted Stock Units Vesting Schedule*" on page 45.

Time-Lapse Restricted Stock and Time-Lapse Restricted Stock Units Vesting Schedule(a)

	11-11-11(b)	05-05-12(c)	11-10-12(b)	05-04-13(c)	11-02-13(b)	05-03-14(c)	Total
Robert W. Best	13,328	28,000	8,472	24,000	8,895	23,100	105,795
Kim R. Cocklin	17,783	14,000	17,383	12,000	9,126	23,100	93,392
Fred E. Meisenheimer	7,672	9,000	9,517	8,000	11,564	7,750	53,503
Louis P. Gregory	11,023	5,000	7,010	5,500	8,991	5,400	42,924
Michael E. Haefner	—	5,000	6,216	5,500	8,106	5,400	30,222

(a) This table does not include amounts of time-lapse RSU's that were issued in November 2011 as a result of elections by the named executive officers to convert all or a portion of incentive compensation.

(b) The amounts represent time-lapse RSU's issued under our LTIP as a result of the participant's election to convert all or a portion of his Incentive Plan payment.

(c) The amounts represent time-lapse RSU's granted under our LTIP. These units vest three years from the date of grant.

Performance-Based Restricted Stock Units Vesting Schedule

	9-30-12	9-30-13	Total
Robert W. Best	24,000	23,100	47,100
Kim R. Cocklin	12,000	23,100	35,100
Fred E. Meisenheimer	8,000	7,750	15,750
Louis P. Gregory	5,500	5,400	10,900
Michael E. Haefner	5,500	5,400	10,900

Option Exercises and Stock Vested

The following table sets forth the exercises of stock options and vested stock received by the named executive officers during fiscal 2011.

Option Exercises and Stock Vested for Fiscal Year 2011

	Option Awards		Stock Awards(a)	
Name	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise ($)	Stock Awards(#)(b)	Value Realized on Vesting ($)(c)
Robert W. Best	285,592	2,224,119	61,340	2,041,202
Kim R. Cocklin	—	—	58,636	1,822,437
Fred E. Meisenheimer	—	—	15,758	508,079
Louis P. Gregory	—	—	16,677	536,542
Michael E. Haefner	—	—	8,877	290,639

(a) The named executive officers elected to have vested shares withheld, in each case, to cover applicable state and federal taxes incurred, upon receipt of their vested shares.

(b) Includes shares that vested during fiscal 2011 attributable to time-lapse RSU's and performance-based RSU's, including shares received as dividend equivalents on performance-based RSU's over the three fiscal-year performance period.

(c) The value received on vesting represents the market value of the shares received based on the mean of the highest and lowest prices of our common stock as reported on the NYSE Consolidated Tape on the vesting dates as follows: $29.33 on October 1, 2010; $30.36 on November 5, 2010; $34.74 on April 29, 2011; $32.60 on June 2, 2011 and $32.87 on September 30, 2011.

Pension Benefits

The table below shows the present value of accumulated benefits payable to each of the named executive officers, including the number of years of service credited to each such named executive officer under our PAP and Supplemental Plans, along with the total amount of payments made during fiscal 2011. See the discussion under "*Pension Account Plan*" below and "*Supplemental Plans,*" beginning on page 47 for more information on these plans. We used the following assumptions in calculating the present value of accumulated benefits for the PAP and Supplemental Plans:

Pension Benefits for Fiscal Year 2011

- Retirement age: (a) 65, or current age if later, for the PAP (62, or current age if later, for Mr. Best, since he was a participant in the Company's retirement plan in 1998 at the time of the adoption of the PAP and thus is eligible for "grandfathered benefits")
  (b) 62, or current age if later, for the Company's Supplemental Executive Benefits Plan ("SEBP") and the Company's Supplemental Executive Retirement Plan ("SERP")
- Discount Rate: 5.05 percent
- Postretirement mortality: Use of the applicable mortality table for 2011, as defined in Code Section 417(e)(3)

Name	Plan Name	Number of Years Credited Service(#)	Present Value of Accumulated Benefit($)	Payments During Last Fiscal Year($)
Robert W. Best(a)	Pension Account Plan	14.500	555,177	—
	Supplemental Executive Benefits Plan	14.500	15,992,202	—
Kim R. Cocklin(b)	Pension Account Plan	5.333	88,647	—
	Supplemental Executive Retirement Plan	5.333	3,577,152	—
Fred E. Meisenheimer(c)	Pension Account Plan	11.167	224,190	—
	Supplemental Executive Retirement Plan	11.167	4,750,854	—
Louis P. Gregory(d)	Pension Account Plan	11.000	195,909	—
	Supplemental Executive Retirement Plan	11.000	2,930,986	—
Michael E. Haefner(e)	Pension Account Plan	3.250	44,752	—
	Supplemental Executive Retirement Plan	3.250	643,634	—

(a) Mr. Best is currently eligible for retirement in each plan.

(b) Mr. Cocklin is eligible for early retirement with an immediate PAP benefit and a reduced benefit under the SERP.

(c) Mr. Meisenheimer is currently eligible for retirement in each plan.

(d) Mr. Gregory is currently eligible for early retirement with an immediate PAP benefit and a reduced benefit under the SERP.

(e) Upon attainment of age 55, Mr. Haefner will be eligible for early retirement with an immediate PAP benefit and a reduced benefit under the SERP.

Retirement Plans

Pension Account Plan. Our PAP is a qualified, cash balance defined benefit pension plan under both the Code and the Employee Retirement Income Security Act of 1974, as amended. The plan covers a majority of our employees, including all named executive officers. Benefits under this plan become vested and non-forfeitable after completion of three years of continuous employment. Under

the terms of the PAP, a vested participant receives a benefit based on the value of the cash balance account at termination or retirement from the Company. Benefits payable under our retirement plan are not offset by Social Security benefits. Under the Code, the annual compensation of each employee to be taken into account under our retirement plan for 2011 cannot exceed $245,000.

The earnings utilized in the PAP include W-2 earnings, 401(k) deferrals and Code Section 125 ("cafeteria plan") reductions, while it excludes all incentive pay and expense reimbursements. All participants are fully vested in their account balances after three years of eligible service and may choose to receive their account balances in the form of a lump sum or an annuity. For any named executive officer who retires with vested benefits under the plan, the compensation shown as "Salary" in the "*Summary Compensation Table for Fiscal Year 2011*," beginning on page 39 would be considered eligible compensation in determining benefits, subject to applicable limitations under the Code.

Supplemental Plans. Mr. Best also participates in the Company's SEBP, while Messrs. Cocklin, Meisenheimer, Gregory and Haefner participate in the Company's SERP, (collectively, the "Supplemental Plans"), which provide retirement benefits (as well as supplemental disability and death benefits) to most officers, division presidents and other employees, all as approved by the Board. For any participant in the SERP prior to November 2008, the SERP provides that an officer or division president (or any other employee selected by the Board) who has participated in the SERP for at least two years and has attained age 55 is entitled to an annual supplemental pension in an amount that, when added to his or her annual pension payable under the PAP, equals 60 percent of his compensation, subject to reductions for less than ten years of employment and for retirement prior to age 62. Mr. Best is entitled to 75 percent of his compensation under the SEBP. The Board amended the SERP to provide that any participant who begins participation in the SERP beginning in November 2008 must have participated in the SERP for at least three years and attained age 55 to receive the same benefits, subject to reductions for less than ten years of participation in the plan and for retirement prior to age 62.

The Supplemental Plans cover compensation in an amount equal to the sum of (a) the greater of the participant's annual base salary at the date of termination of employment or the average of the participant's annual base salary for the highest of three calendar years (whether or not consecutive) of employment with the Company and (b) the greater of the amount of the participant's last award under any of the Company's annual performance bonus or incentive plans or the average of the participant's highest three performance awards under such plans (whether or not consecutive). The amount of current compensation covered by the Supplemental Plans as of the end of fiscal 2011 for each of the named executive officers listed in the Summary Compensation Table is as follows: Mr. Best, $1,629,207; Mr. Cocklin, $1,344,700; Mr. Meisenheimer, $644,750; Mr. Gregory, $516,480 and Mr. Haefner, $477,750.

Each of the named executive officers has also entered into a participation agreement with the Company as required by the Supplemental Plans. Each of the Supplemental Plans provides that the accrued benefits, as calculated pursuant to the plan, of each participant will vest if: (a) the plan is terminated by the Company; (b) the plan is amended by the Company, resulting in a decrease in the benefits otherwise payable to the participant; (c) the participant's employment is terminated by the Company for any reason other than "cause"; (d) the participant's participation in the plan is terminated by the Company for any reason other than "cause" prior to the participant's termination of employment; (e) within any time during the three-year period following a "change of control" of the

Company (as such term is defined in the plan), (i) the participant's employment is terminated involuntarily by the Company for any reason other than "cause" or (ii) the participant is demoted or reassigned to a position that would cause him to cease to be eligible for participation in the plan; or (f) in anticipation of a "change in control" (whether or not a "change in control" ever occurs), if (i) the participant's employment is terminated involuntarily by the Company for any reason other than "cause" at the request of a party to a pending transaction that would constitute a "change in control," if and when the transaction were consummated or (ii) the participant's participation in the plan is terminated for any reason other than "cause" prior to the participant's termination of employment. The participation agreements set forth the specific rights of the participants to their accrued benefits upon the occurrence of the events described above and constitute enforceable contracts separate from the provisions of the Supplemental Plans.

Change in Control Severance Agreements

We have entered into severance agreements with each of the current named executive officers to provide certain severance benefits for them in the event of the termination of their employment within three years following a "change in control" of the Company (as defined in the severance agreements and described generally below). In addition, such executive officer will be entitled to all rights and benefits, if any, provided under any other plan or agreement between him and the Company.

The severance agreement for each named executive officer generally provides that the Company will pay such officer as severance pay in one lump sum an amount equal to (a) 2.5 times his total compensation (annual base salary and average amount of annual incentive compensation received under the Incentive Plan) and (b) the total of (i) an amount that is actuarially equivalent to an additional three years of annual age and service credits payable to the officer under the PAP and (ii) an amount that is actuarially equivalent to an additional three years of Company matching contributions payable to the officer under the RSP. The Company is also obligated to provide the officer with all medical, dental, vision and any other health benefits which qualify for continuation coverage under Code Section 4980B, for a period of 18 months from the date of termination. In addition, following the end of the 18-month period, the Company is to pay such officer a lump sum amount equal to the present value of the cost to the Company of providing those benefits to him for an additional 18-month period. Also, the Company must pay the officer a lump sum amount equal to the present value of the cost to the Company of providing accident and life insurance benefits as well as disability benefits for a period of 36 months from his date of termination, equal to such benefits in effect for the officer at the time of the change in control.

However, if an executive officer is terminated by the Company for "cause" (as defined in the severance agreement), or his employment is terminated by retirement, death or disability, the Company is not obligated to pay such officer the lump sum severance payment. Further, if an executive officer voluntarily terminates his employment except for "constructive termination" (as defined in the severance agreement), the Company is not obligated to pay such officer the lump sum severance payment. Also, beginning in fiscal 2010, the Company eliminated the payment of any excise tax gross-up payments which may be due on the payment of severance benefits to onr named executive officers. As a result, if such lump sum severance benefit payments result in the imposition of excise taxes imposed by Section 4999 of the Code, for which the officer is now responsible for paying, the officer will have the option to elect to have the payment reduced to a level that will result in no payment of such excise tax by such officer.

For the purposes of these agreements, a "change in control" will generally be deemed to have occurred at any one of the following times:

- on the date any person acquires ownership of stock, that together with stock already held by such person, results in the person having beneficial ownership of 50 percent or more of the total fair market value or total voting power of our stock;
- on the date that a person acquires or has acquired over a 12-month period ownership of our stock possessing 30 percent or more of the total voting power of our stock;
- on the date a majority of the members of our Board is replaced during any 12-month period by directors whose election is not endorsed by a majority of the Board before the date of the election; or
- on the date that a person acquires at least 40 percent of the total gross fair market value of our assets over a 12-month period immediately before such acquisition, except if such sale is to a person or entity owning, directly or indirectly, at least 50 percent of the total value or voting power of our stock before such acquisition.

For the purposes of these severance agreements, "cause" means (i) the willful and continued failure by the employee to substantially perform his duties with the Company (other than any such failure resulting from his incapacity due to physical or mental illness) after a written demand for substantial performance is delivered to the employee by the Board that specifically identifies the manner in which the Board believes that the employee has not substantially performed his duties or (ii) an employee's willful engagement in conduct that is demonstrably and materially injurious to the Company, monetarily or otherwise. No act, or failure to act, on an employee's part shall be deemed "willful" unless done, or omitted to be done, by the employee not in good faith and without a reasonable belief that the action or omission was in the best interests of the Company. Notwithstanding the foregoing, the employee shall not be deemed to have been terminated for cause unless approved by an affirmative vote of not less than three-quarters (3/4) of the entire membership of our Board at a meeting called and held for such determination.

Potential Payments Upon Termination or Change in Control

Payments Made Upon Any Termination. Regardless of the manner in which a named executive officer's employment is terminated, he is entitled to receive the following amounts earned during his term of employment. Such amounts include:

- amount of accrued but unpaid salary;
- amounts contributed under, or otherwise vested in our RSP;
- amounts accrued and vested through our PAP and Supplemental Plans; and
- amounts attributable to the exercise of rights with respect to each outstanding and vested stock option granted under our LTIP.

Payments Made Upon Retirement. In the event of the retirement of a named executive officer, in addition to the items identified above, such named executive officer will:

- be entitled to receive a *pro rata* portion, at the end of the three-year performance period, based on the number of months completed of such performance period, of each outstanding grant of performance-based RSU's under our LTIP, at a value equal to the actual level of performance achieved during the period; and

- be entitled to receive, upon the termination of the restricted period, shares of stock equal to the number of time-lapse RSU's granted under our LTIP or issued as a result of an election to convert all or a portion of an Incentive Plan payment.

Payments Made Upon Death or Disability. In the event of the death or disability of a named executive officer, in addition to the benefits listed under the headings, "*Payments Made Upon Any Termination*" and "*Payments Made Upon Retirement*", the named executive officer or designated beneficiary will receive benefits under the Company's disability plan or payments under the Company's life insurance plan, as appropriate.

Payments Made Upon a Change in Control. As discussed above in "*Change in Control Severance Agreements*," beginning on page 48, we have also entered into severance agreements with each of the named executive officers to provide certain severance benefits for them in the event of the termination or "constructive termination" of their employment within three years following a "change in control" of the Company, as such terms are defined in the agreements. As is also discussed above, the severance agreements for each of the named executive officers were modified beginning in fiscal 2010 to the "best net" approach, so that the Company would no longer be liable for the tax gross-up payments on behalf of those individuals whose severance payments would have triggered excise tax penalties. In the tables below under the heading "*Termination Upon Change in Control*," we assume the named executive officers would pay any related excise tax penalties. The severance agreement for each such executive officer provides that the Company will pay such executive officer a lump sum severance payment as described above in "*Change in Control Severance Agreements*."

In the tables below, "*Potential Post-Employment Payment Tables*," beginning on page 52, we have shown the severance compensation and employee benefits to be provided in the aggregate to each named executive officer in the event of each of five termination scenarios. In each scenario, there are differences in how retirement benefits and health and welfare benefits are determined. The following discussion provides more specific information on the retirement benefits and health and welfare benefits under each of the various scenarios:

Termination Upon Death. The SEBP/SERP benefit is the sum of the following:

- two times final average earnings (base salary plus annual payment under the Incentive Plan) less the amount paid through the Company's group life insurance plan;
- a life annuity benefit of 50 percent of final average earnings (base salary plus annual payment under the Incentive Plan) payable to the surviving spouse;
- a temporary life annuity benefit of 25 percent of final average earnings (base salary plus annual payment under Incentive Plan) payable to dependent children until children reach the age of 18 years;
- the PAP plan benefit equal to the account balance at the time of death; and
- the RSP plan benefit equal to the account balance at the time of death.

Termination Upon Disability. The SERP/SEBP benefit is the sum of the following:

- a monthly benefit based on 60 percent of compensation (base salary plus annual payment under the Incentive Plan) less the amount paid from the Company's group disability plan, with this net benefit payable as a temporary benefit until the age of 65 years;
- regular retirement benefit (described below in "*Termination Upon Retirement*") payable after age of 65 years;

- the PAP plan benefit equal to the value of the projected age 65 monthly benefit assuming level future earnings from date of disability; and
- the RSP plan benefit equal to the account balance at the time of disability.

Termination Upon Retirement. For Mr. Best, the SEBP/SERP benefit at retirement is the lump sum benefit equal to a target benefit of 75 percent of final average earnings (base salary plus annual payment under the Incentive Plan) less an offset for the benefits to be paid from the tax-qualified PAP. For the other four named executive officers, their SEBP/SERP benefit at retirement is the lump sum benefit equal to a target benefit of 60 percent of final average earnings (base salary plus annual payment under the Incentive Plan) less an offset for the benefits to be paid from the tax-qualified PAP. In addition, the following benefits are payable at retirement:

- the PAP plan benefit equal to the account balance at the time of retirement; and
- the RSP plan benefit equal to the account balance at the time of disability.

Termination Without Cause. The retirement benefits for a termination without cause are equal to the same retirement benefits as described above with respect to termination upon retirement.

Termination Upon Change in Control. The SEBP/SERP benefit upon termination pursuant to a change in control is equal to the same retirement benefits as described above with respect to termination upon retirement with the following additional provisions:

- there is no reduction applied to the earned benefit in the event that the executive has less than 10 years of service;
- there is no reduction applied to the earned benefit for early commencement prior to age 62;
- the executive officer is immediately vested in the accrued benefit;
- in addition, the PAP benefit includes the accrued benefit at the time of termination plus an additional three years of earned compensation credits; and
- the RSP benefit includes the accrued benefit at the time of termination plus an additional three years of Company matching contributions.

Health and Welfare Benefits. The Company only provides supplemental benefits in the form of health and welfare benefits in the event of the termination of a named executive officer pursuant to a change in control. The supplemental health and welfare benefit reported in the following table represents the benefits described above under "*Payments Made Upon a Change in Control,*" beginning on page 50.

Potential Post-Employment Payment Tables. The following tables reflect estimates of the total amount of compensation due each named executive officer in the event of such executive's termination of employment by reason of death, disability or retirement, termination of employment without cause, or termination of employment following a change in control. The amounts shown below assume that such termination was effective as of September 30, 2011 and are estimates of the amounts which would be paid out to the executives upon such termination. The actual amounts to be paid out can only be determined at the time of such executive's separation from the Company.

In addition to the amounts set forth in the following table, in the event of his termination of employment for any reason, Mr. Best would receive a total of $705,738 in exercisable options which had been earned as of September 30, 2011.

Robert W. Best	Termination Upon Death($)	Termination Upon Disability($)	Termination Upon Retirement($)	Termination Without Cause($)	Termination Upon Change in Control($)
Cash Severance	—	—	—	—	3,741,293
Equity					
Time-Lapse Restricted Stock/ Restricted Stock Units	3,433,048	3,433,048	3,433,048	3,001,554	3,433,048
Performance-Based Restricted Stock Units	825,419	825,419	825,419	825,419	825,419
Total	4,258,467	4,258,467	4,258,467	3,825,973	4,258,467
Retirement Benefits					
Pension Account Plan	519,391	557,850	519,391	519,391	589,602
Supplemental Executive Benefits Plan	12,798,475	15,417,904	15,430,338	15,430,338	15,430,338
Retirement Savings Plan	1,826,584	1,826,584	1,826,584	1,826,584	1,853,247
Total	15,144,450	17,802,338	17,776,313	17,776,313	17,873,187
Other Benefits					
Health & Welfare	—	—	—	—	40,453
Total	19,402,917	22,060,805	22,034,780	21,602,286	25,913,400

Kim R. Cocklin	Termination Upon Death($)	Termination Upon Disability($)	Termination Upon Retirement($)	Termination Without Cause($)	Termination Upon Change in Control($)
Cash Severance	—	—	—	—	3,361,750
Equity					
Time-Lapse Restricted Stock/ Restricted Stock Units	3,030,570	3,030,570	3,030,570	2,453,512	3,030,570
Performance-Based Restricted Stock Units	542,836	542,836	542,836	542,836	542,836
Total	3,573,406	3,573,406	3,573,406	2,996,348	3,573,406
Retirement Benefits					
Pension Account Plan	84,238	194,671	84,238	84,238	144,698
Supplemental Executive Retirement Plan	9,252,468	5,937,578	4,755,542	4,755,542	9,335,574
Retirement Savings Plan	156,675	156,675	156,675	156,675	183,338
Total	9,493,381	6,288,924	4,996,455	4,996,455	9,663,610
Other Benefits					
Health & Welfare	—	—	—	—	40,453
Total	13,066,787	9,862,330	8,569,861	7,992,803	16,639,219

Fred E. Meisenheimer	Termination Upon Death($)	Termination Upon Disability($)	Termination Upon Retirement($)	Termination Without Cause($)	Termination Upon Change in Control($)
Cash Severance	—	—	—	—	1,611,875
Equity					
Time-Lapse Restricted Stock/Restricted Stock Units	1,736,172	1,736,172	1,736,172	1,657,216	1,736,172
Performance-Based Restricted Stock Units	275,703	275,703	275,703	275,703	275,703
Total	2,011,875	2,011,875	2,011,875	1,762,919	2,011,875
Retirement Benefits					
Pension Account Plan	224,805	224,805	224,805	224,805	295,016
Supplemental Executive Retirement Plan	4,628,415	4,594,253	4,594,253	4,594,253	4,594,253
Retirement Savings Plan	246,443	246,443	246,443	246,443	273,106
Total	5,099,663	5,065,501	5,065,501	5,065,501	5,162,375
Other Benefits					
Health & Welfare	—	—	—	—	40,453
Total	7,111,538	7,077,376	7,077,376	6,828,420	8,826,578

Louis P. Gregory	Termination Upon Death($)	Termination Upon Disability($)	Termination Upon Retirement($)	Termination Without Cause($)	Termination Upon Change in Control($)
Cash Severance	—	—	—	—	1,291,200
Equity					
Time-Lapse Restricted Stock/Restricted Stock Units	1,392,884	1,392,884	1,392,884	1,035,188	1,392,884
Performance-Based Restricted Stock Units	190,356	190,356	190,356	190,356	190,356
Total	1,583,240	1,583,240	1,583,240	1,225,544	1,583,240
Retirement Benefits					
Pension Account Plan	189,015	385,610	189,015	189,015	249,475
Supplemental Executive Retirement Plan	4,274,751	3,898,821	3,444,992	3,444,992	4,385,380
Retirement Savings Plan	432,839	432,839	432,839	432,839	459,502
Total	4,896,605	4,717,270	4,066,846	4,066,846	5,094,357
Other Benefits					
Health & Welfare	—	—	—	—	54,833
Total	6,479,845	6,300,510	5,650,086	5,292,390	8,023,630

Michael E. Haefner	Termination Upon Death($)	Termination Upon Disability($)	Termination Upon Retirement($)	Termination Without Cause($)	Termination Upon Change in Control($)
Cash Severance	—	—	—	—	1,194,375
Equity					
Time-Lapse Restricted Stock/Restricted Stock Units	[illegible]	[illegible]	—	—	[illegible]
Performance-Based Restricted Stock Units	190,356	190,356	—	—	190,356
Total	1,171,060	1,171,060	—	—	1,171,060
Retirement Benefits					
Pension Account Plan	43,888	272,756	43,888	43,888	90,803
Supplemental Executive Retirement Plan	3,879,354	2,004,773	—	—	3,624,792
Retirement Savings Plan	109,205	109,205	109,205	109,205	135,868
Total	4,032,447	2,386,734	153,093	153,093	3,851,463
Other Benefits					
Health & Welfare	—	—	—	—	54,477
Total	5,203,507	3,557,794	153,093	153,093	6,271,375

AUDIT COMMITTEE REPORT

The Audit Committee of the Board of Directors is composed of five directors who are independent directors as required by and in compliance with all applicable listing standards of the NYSE as well as all applicable rules and regulations of the SEC, as discussed in the "*Corporate Governance and Other Board Matters*" section of this proxy statement, beginning on page 3. The Audit Committee acts under a written charter adopted by the Board of Directors, which sets forth its detailed responsibilities and duties, as well as requirements for the Audit Committee's composition and meetings. A copy of the charter is available on the Corporate Governance page of the Company's website.

The primary purpose of the Audit Committee is to oversee the Company's financial reporting process on behalf of the Board of Directors. Management has the primary responsibility for the financial statements and the financial reporting process, including systems of internal control over financial reporting and disclosure controls and procedures. Ernst & Young is responsible for (i) expressing an opinion, based on its audit, as to the conformity of the audited financial statements with generally accepted accounting principles and (ii) expressing an opinion, based on its audit, on the effectiveness of the Company's internal control over financial reporting.

In fulfilling its oversight responsibilities, the Audit Committee reviewed and discussed the audited financial statements in the Company's 2011 Annual Report on Form 10-K with both management and Ernst & Young, which included a discussion of the critical accounting policies and practices used by the Company, and alternative treatments of financial information within generally accepted accounting principles, if any, and their effects, including the treatments preferred by the independent registered public accounting firm, if applicable. In addition, the Audit Committee reviewed all other material communications between the Company and Ernst & Young.

Management has represented to the Audit Committee that the Company's internal control over financial reporting is effective. The Audit Committee then reviewed and discussed management's assessment with management and Ernst & Young. The Audit Committee also discussed with Ernst & Young its report on the Company's internal control over financial reporting as well as the matters required to be discussed under generally accepted auditing standards, including those matters set forth in Statement on Auditing Standards No. 61, (AICPA, *Professional Standards*, Vol. 1, AU Section 380), as adopted by the Public Company Accounting Oversight Board in its Rule 3200T.

In addition, the Audit Committee has received and reviewed the written disclosures and letter from Ernst & Young, which are required by applicable requirements of the Public Company Accounting Oversight Board, regarding the independent registered public accounting firm's communications with the Audit Committee concerning independence and discussed with Ernst & Young the firm's independence, as well as those disclosures related to the independence of the Company's independent registered public accounting firm required by the provisions of the Sarbanes-Oxley Act of 2002 and related rules and regulations of the SEC. The Audit Committee has also considered the fees paid to Ernst & Young during the last fiscal year for audit and non-audit services and has determined that the non-audit services provided are compatible with the firm's independence and are in compliance with applicable law.

The Audit Committee has also discussed with KPMG, which provides internal audit services to the Company, and Ernst & Young, the overall scope and plans for their respective audits. The Audit Committee periodically meets with both firms, with and without management present, to discuss the results of their examinations, the assessments of the Company's internal control over financial reporting, as well as the overall quality of the Company's financial reporting.

In reliance on the reviews and discussions referred to above, the Audit Committee recommended to the Board of Directors (which the Board has approved) that the Company's audited financial statements be included in its Annual Report on Form 10-K for the year ended September 30, 2011 for filing with the SEC. The Audit Committee has also appointed Ernst & Young as the Company's independent registered public accounting firm for the 2012 fiscal year, which appointment is being submitted to our shareholders for their ratification at our 2012 annual meeting of shareholders.

Respectfully submitted by the members of the Audit Committee of the Board of Directors:

Nancy K. Quinn, Chair
Ruben E. Esquivel
Robert C. Grable
Dr. Thomas C. Meredith
Richard Ware II

PROPOSAL TWO—RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Audit Committee of the Board has appointed Ernst & Young to continue as our independent registered public accounting firm for the fiscal year ending September 30, 2012. The firm of Ernst & Young (and its predecessors) has been our independent registered public accounting firm since our incorporation in 1983. It is expected that representatives of Ernst & Young will be present at the annual meeting. The representatives of Ernst & Young will have the opportunity to make a statement if they desire to do so and are expected to be available to respond to appropriate questions.

As a matter of good corporate governance, the Company submits the Audit Committee's selection of Ernst & Young as its independent registered public accounting firm to our shareholders for ratification each year. If the selection of Ernst & Young is not ratified by a majority of our common stock present or represented by proxy and entitled to vote on the matter, the Audit Committee will take into account the outcome of the vote in its future selection of an independent registered public accounting firm.

Audit and Related Fees

Fees for professional services provided by our independent registered public accounting firm, Ernst & Young, in each of the last two fiscal years, in each of the following categories are:

	September 30	
	2011	2010
	($ In thousands)	
Audit Fees	3,030	2,884
Audit-Related Fees	56	64
Tax Fees	115	295
All Other Fees	—	—
Total Fees	3,201	3,243

Audit Fees. Fees for audit services include fees associated with the annual audit, the assessment by the firm of our design and operating effectiveness of internal control over financial reporting and the reviews of our quarterly reports on Form 10-Q, along with comfort letters and consents related to our debt offering.

Audit-Related Fees. Audit-related fees principally include fees relating to procedures performed in connection with the statutory audit of the Company's wholly-owned subsidiary, Blueflame Insurance Services, Ltd., and the examination of the Illinois Annual Reconciliation of Over/Under Gas Recoveries.

Tax Fees. Tax fees include fees relating to reviews of tax returns, tax consulting and assistance with sales and use tax filings and audits.

As discussed in "*Audit Committee Pre-Approval Policy*" on page 11, all professional services provided by Ernst & Young were pre-approved by the Audit Committee in accordance with its pre-approval policy.

THE BOARD OF DIRECTORS RECOMMENDS THAT SHAREHOLDERS VOTE "FOR" THE RATIFICATION OF THE APPOINTMENT OF ERNST & YOUNG LLP AS THE COMPANY'S INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR FISCAL 2012.

PROPOSAL THREE—NON-BINDING, ADVISORY VOTE ON APPROVAL OF EXECUTIVE COMPENSATION

Background of the Proposal

We are required by Section 14A of the Securities Exchange Act to hold a separate non-binding, advisory shareholder vote to approve the compensation of our executive officers as described in the Compensation Discussion and Analysis, the executive compensation tables and any related information in our proxy statement (commonly known as the "Say on Pay" proposal). At our last annual meeting of shareholders on February 9, 2011, our shareholders voted overwhelmingly to adopt the recommendation of our Board to vote on the Say on Pay proposal every year at our annual meeting. As a result, we will submit our Say on Pay proposal to our shareholders at each annual meeting until we are required to submit to our shareholders within the next five years another proposal on the frequency of the vote on the Say on Pay proposal.

Executive Compensation

As discussed above in the "*Compensation Discussion and Analysis,*" section of this proxy statement, beginning on page 26, the Board believes that our current executive compensation program directly links executive compensation to our financial performance and align the interests of our executive officers with those of our shareholders. Our Board also believes that our executive compensation program provides our executive officers with a balanced compensation package that includes a reasonable base salary along with annual and long-term incentive compensation plans that are based on the Company's financial performance. These incentive plans are designed to reward our executive officers on both an annual and long-term basis if they attain specified target goals, the attainment of which do not require the taking of an unreasonable amount of risk, as discussed above in "*Compensation Risk Assessment,*" beginning on page 12. Our shareholders overwhelmingly approved this executive compensation philosophy when they approved the executive compensation of our named executive officers at our last annual meeting. See "*Additional Information on Executive Compensation,*" beginning on page 34.

The HR Committee periodically reviews the Company's overall approach to executive compensation to see that the Company's current benefits, perquisites, policies and practices continue to be in line with the best practices of companies in the natural gas distribution industry and in other Fortune 500 companies and to assist us with the hiring and retention of a high-quality management team. As a result, during the past several years, (as discussed above in "*Compensation Discussion and Analysis,*" beginning on page 26) the committee recommended changes to our executive compensation program, which changes were approved by the Board, as follows:

- Reduction in premium paid from 50 percent to 20 percent of the value at the date of grant of time-lapse RSU's granted to participants in our Incentive Plan who elect to convert all or a portion of their incentive payments to such equity grants. Also, reduction in premium from 10 percent to five percent of the value at the date grant of shares of bonus stock granted to participants who elect to convert all or a portion of their incentive payments to such equity grants;
- Exclusion from the performance targets and actual performance attainment for both the Incentive Plan and performance-based RSU's granted under the LTIP of any mark-to-market gains or losses recognized by the Company's nonregulated operations;

- Adoption of a clawback policy, which provides for the recoupment by the Company under certain circumstances of all incentive compensation paid to all our corporate officers and division presidents;
- Adoption of a policy that prohibits hedging transactions in our common stock by employees and directors of Atmos Energy;
- Imposition of a limit, at the target level of performance, on both short-term and long-term incentive compensation paid to our named executive officers if our Total Shareholder Return during the fiscal year or during the three fiscal year performance period is negative;
- Elimination of any excise tax gross-up payments made by the Company, to our named executive officers, which may be due on payment of severance benefits paid in the case of a change in control; and
- Enforcement of restriction period through the end of the relevant three-year restriction period on all equity grants under our LTIP for all recipients who have retired prior to the expiration of such restricted period.

The "*Compensation Discussion and Analysis*" discussion, beginning on page 26, includes additional details about our executive compensation program. This Say on Pay proposal is set forth in the following resolution:

> RESOLVED, that the shareholders of Atmos Energy Corporation approve, on an advisory basis, the compensation of its named executive officers for fiscal 2011, as disclosed in the Company's Proxy Statement for the 2012 Annual Meeting of Shareholders, pursuant to the compensation disclosure rules of the Securities and Exchange Commission, including the Compensation Discussion and Analysis, the compensation tables, and any related information found in the proxy statement of Atmos Energy Corporation.

Because your vote on this proposal is advisory, it will not be binding on the Board or the Company. However, the HR Committee and the Board of Directors will take into account the outcome of the vote when considering future executive compensation arrangements.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE "FOR" THE APPROVAL OF EXECUTIVE COMPENSATION OF OUR NAMED EXECUTIVE OFFICERS, AS DISCLOSED IN THIS PROXY STATEMENT, PURSUANT TO THE COMPENSATION DISCLOSURE RULES OF THE SECURITIES AND EXCHANGE COMMISSION.

OTHER MATTERS

Shareholder Proposals

In the event a shareholder intends to present a proposal at our annual meeting of shareholders on February 8, 2012, in accordance with the Company's bylaws, the shareholder must be a shareholder of record on the record date, December 12, 2011, who shall continue to be entitled to vote at the annual meeting and who mails a notice of such proposal so that it is received by the Corporate Secretary at our principal executive offices by January 16, 2012 and includes the information required by the Company's bylaws. In the event a shareholder intends to present a proposal at our 2013 annual meeting of shareholders, if such proposal is to be included in our proxy statement relating to such meeting, it must be received by the Corporate Secretary at our principal executive offices no later than August 24, 2012 and it must be prepared according to applicable law, as determined by the Company.

Other Business

We know of no other business that may come before the annual meeting. However, if any other matters are properly brought before the meeting by the management or any shareholder, it is the intention of each person named in the accompanying proxy to vote such proxy in accordance with his judgment on such matters. The proxy confers discretionary authority to take action with respect to any such additional matters that may come before the meeting.

Annual Report

A copy of our Annual Report on Form 10-K for the fiscal year ended September 30, 2011, including the financial statements and the financial statement schedules included therein, accompanies this proxy statement. In addition, the exhibits of the Annual Report on Form 10-K are available upon payment of charges that approximate our cost of reproduction. **If you would like to receive a copy of these exhibits, please call Shareholder Relations at 972-855-3792 or mail your written request to Shareholder Relations, Atmos Energy Corporation, P.O. Box 650205, Dallas, Texas 75265-0205.**

By Order of the Board of Directors,

Dwala Kuhn

Dwala Kuhn
Corporate Secretary

Dallas, Texas
December 22, 2011

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BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION
AT NASHVILLE, TENNESSEE

IN RE:	)	
	)	
CHATTANOOGA GAS COMPANY PETITION FOR APPROVAL OF AN ADJUSTMENT IN RATES AND TARIFF; THE TERMINATION OF THE AUA MECHANISM AND THE RELATED TARIFF CHANGES AND REVENUE DEFICIENCY RECOVERY; AND AN ANNUAL RATE REVIEW MECHANISM	)	**DOCKET NO. 18-00017**

DIRECT TESTIMONY

OF

DAVID DITTEMORE

July 3, 2018

BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION
AT NASHVILLE, TENNESSEE

IN RE:	)	
	)	
CHATTANOOGA GAS COMPANY PETITION FOR APPROVAL OF AN ADJUSTMENT IN RATES AND TARIFF; THE TERMINATION OF THE AUA MECHANISM AND THE RELATED TARIFF CHANGES AND REVENUE DEFICIENCY RECOVERY; AND AN ANNUAL RATE REVIEW MECHANISM	)	**DOCKET NO. 18-00017**

AFFIDAVIT

I, David N. Dittemore, Financial Analyst, on behalf of the Consumer Advocate Division of the Attorney General's Office, hereby certify that the attached Direct Testimony represents my opinion in the above-referenced case and the opinion of the Consumer Protection and Advocate Division.

David N. Dittemore

DAVID N. DITTEMORE

EMILY KNIGHT
STATE OF TENNESSEE NOTARY PUBLIC
DAVIDSON COUNTY
My Commission Expires MAY 6, 2019

Sworn to and subscribed before me this 6th day of July, 2018.

Emily Knight

NOTARY PUBLIC

My commission expires: May 6, 2019

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ATTACHMENTS

David N. Dittemore Vitae	**Exhibit DND-1**
CPAD Operations and Maintenance Expense	**Attachment DD-1**

Q1. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND OCCUPATION FOR THE RECORD.

A1. My name is David N. Dittemore. I am a Financial Analyst employed by the Consumer Protection and Advocate Division within the Office of the Tennessee Attorney General (Consumer Advocate). My business address is Office of the Tennessee Attorney General, UBS Tower, 315 Deaderick Street, Nashville, TN 37243.

Q2. PLEASE PROVIDE A SUMMARY OF YOUR BACKGROUND AND PROFESSIONAL EXPERIENCE.

A2. I received a Bachelor of Science Degree in Business Administration from the University of Central Missouri in 1982. I am a Certified Public Accountant licensed in the state of Oklahoma (#7562). I was previously employed by the Kansas Corporation Commission (KCC) in various capacities, including Managing Auditor, Chief Auditor, and Director of the Utilities Division. For approximately four years, I was self-employed as a Utility Regulatory Consultant representing primarily the KCC Staff in regulatory issues. I also participated in proceedings in Georgia and Vermont, evaluating issues involving electricity and telecommunications regulatory issues. Additionally, I performed a consulting engagement for Kansas Gas Service (KGS), my subsequent employer during this time frame. For eleven years, I served as Manager and subsequently Director of Regulatory Affairs for KGS, the largest natural gas utility in Kansas, serving approximately 625,000 customers. KGS is a division of One Gas, a natural gas utility serving approximately two million customers in Kansas, Oklahoma, and Texas. I joined the Office of the Tennessee Attorney General in September, 2017 as a Financial Analyst. In total, I have over thirty years' experience in the field of public utility regulation. I have presented testimony as an expert witness on numerous occasions. Attached as Exhibit 1 is a detailed vita of my professional background.

Q3. HAVE YOU PREVIOUSLY PROVIDED TESTIMONY BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION (TPUC)?

A3. Yes. I have submitted testimony in TPUC Docket Nos. 17-00014, 17-00108, 17-00138, 17-00124, and 17-00143.

Q4. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A4. My testimony will support and address the Consumer Advocate's positions with respect to the attrition period Operating and Maintenance (O&M) Expenses,[1] Taxes Other than Income, Cash Working Capital, and Accumulated Deferred Income Tax (ADIT) balances, including the impacts of the Tax Cuts and Jobs Act (TCJA). I will also identify and discuss certain accounting concerns regarding cost allocation processes and make recommendations for enhancing the quality and transparency of these costs within regulatory filings. Finally, I will address how Chattanooga Gas Company (CGC or the Company) has not demonstrated it has in place sufficient controls over its cost allocation processes that would demonstrate the necessary practices and procedures for determining on-going O&M costs.

I. OVERVIEW OF THE SOUTHERN COMPANY

Q5. PLEASE PROVIDE AN OVERVIEW OF THE SOUTHERN COMPANY, INCLUDING THE AFFILIATES OF CGC.

A5. The Southern Company provides retail electricity and natural gas at the retail level to more than nine million customers. In addition to its regulated electricity and natural gas service, The Southern Company also engages in significant non-regulated operations. For example, The Southern Company conducts operations

[1] Consumer Advocate witness Mr. Hal Novak is sponsoring the adjustment to amortize rate case costs.

through affiliated entities in the areas of wholesale competitive power generation, digital communications, and investments in leveraged leases.

Q6. WHICH AFFILIATED ENTITY CONDUCTS RETAIL NATURAL GAS DISTRIBUTION OPERATIONS?

A6. The Southern Company's natural gas operations are conducted by Southern Company Gas (SCG). In July 2016, The Southern Company acquired the assets of SCG, the owner of AGL Resources Inc., which provides natural gas distribution service in seven states. Regulated natural gas operations within SCG include, but are not limited to, Virginia Natural Gas, Atlanta Gas Light Company, and Nicor Gas.

Q7. WOULD YOU PROVIDE A SENSE OF THE SCOPE OF SCG'S NON-REGULATED ACTIVITIES AND AFFILIATES?

A7. SCG also conducts a number of non-regulated commercial activities, including gas marketing, home protection services, gas storage, arbitrage activities, and mid-stream activities. In total there are 82 entities that operate within the SCG organization.[2] The entities do not include other Southern Company affiliates that are not within the SCG umbrella. Corporate services are provided within SCG by its affiliate, Atlanta Gas Service Company (AGSC).

In 2017, AGSC incurred costs in excess of $274 million that were charged to various SCG affiliates.[3] Of this amount, over $5.2 million was charged to CGC, representing approximately 40% of CGC's 2017 total non-purchased gas O&M costs.

[2] Determined by counting the entities listed in Consumer Advocate Discovery Request No. 1-15.
[3] Response to Consumer Advocate Discovery Request No. 1-41.

II. ATTRITION PERIOD O&M COSTS

Q8. WHAT TEST PERIOD AND ATTRITION PERIOD IS THE CONSUMER ADVOCATE USING IN THIS CASE?

A8. As discussed in Mr. Novak's testimony, the Consumer Advocate is using the calendar year 2017 as the Test Period and calendar year 2019 as the Attrition Period.

Q9. DISCUSS THE APPROACH YOU TOOK IN QUANTIFYING PRO-FORMA ATTRITION PERIOD O&M COSTS

A9. First, I identified unadjusted O&M expenses for the twelve-month period ending December 31, 2017,[4] the Test Period for this Docket. Next, I made five adjustments, discussed below, to the Test Period data to determine the pro-forma Test Period O&M. Finally, estimated inflation factors were applied to the pro-forma adjusted Test Period data to arrive at pro-forma Attrition Period data.

Q10. WOULD YOU BRIEFLY OUTLINE THE SIX O&M ADJUSTMENTS YOU AND MR. NOVAK ARE SPONSORING?

A10. Yes. Listed below are the adjustments we are supporting in this Docket for the O&M Expense calculation:

[4]Information obtained in response to Consumer Advocate Discovery Request No. 1-142, as summarized on Consumer Advocate Schedule No. 9, and outlined in greater detail in Consumer Advocate Schedule No. 9-12.

Table 1	
Adjustments to O&M	**Amount**
Test Period O&M	**12,067,184**
[redacted]	
Adjustment 5 Rate Case Amortization	115,718
[redacted]	
Attrition Period O&M	**10,964,177**

I am recommending the Commission approve adjustments on lines 1-4 and 6 above. Mr. Novak, in his testimony describes and recommends the Commission approve the adjustments on line 5.

Q11. PLEASE SUMMARIZE YOUR ADJUSTMENT CONCERNING INCENTIVE COMPENSATION COST, AS SHOWN ON TABLE 1, ADJUSTMENT 1.

A11. This adjustment eliminates $[redacted] in O&M costs associated with Incentive Compensation costs. The components of this adjustment include [redacted] of Incentive Compensation associated with direct CGC labor costs, and [redacted] in Bonus and Long-Term Incentive Compensation allocated to CGC from its affiliate AGSC.

Q12. WERE YOU SURPRISED AT THE LEVEL OF INCENTIVE COMPENSATION IN THIS CASE?

A12. Yes. The magnitude of allocated Incentive Compensation is surprisingly large given the relatively small size of CGC's operations. The CGC Test Period unadjusted O&M charges, excluding gas costs, are just over $12 million. Therefore, the Incentive Compensation costs represent over [redacted]% of the total CGC O&M charges.

Q13. AS BACKGROUND, PLEASE DESCRIBE THE TYPES OF INCENTIVE COMPENSATION AND THE BASIS UPON WHICH SUCH COSTS ARE PAID OUT TO EMPLOYEES.

A13. The Southern Company has two types of Incentive Compensation, short-term and long-term.[5] The short-term program is referred to as the Performance Pay Program and is available to all employees. The Long-Term Incentive Compensation program is available to employees in a certain pay grade.[6] The split of the total Incentive Compensation recorded on CGC books in the Test Period split between Short-Term and Long-Term is:

Short-Term: $[redacted]

Long-Term: $[redacted]

Q14. WHAT IS YOUR RATIONALE FOR YOUR RECOMMENDATION TO REMOVE INCENTIVE COMPENSATION EXPENSE FROM TEST PERIOD O&M?

A14. A significant portion of the Short-Term Incentive Compensation payouts are driven by corporate and business unit financial performance that directly benefits The Southern Company shareholders and therefore such costs should not be borne by CGC ratepayers. These corporate and business unit financial performance goals include metrics that measure The Southern Company's Earnings Per Share (EPS)[7] and those that measure SCG's net income. Further, all Long-Term Incentive Compensation is designed to encourage eligible employees to enhance per-share increases in The Southern Company stock price. The higher the stock price relative to its group of peer electric utilities, the greater the employee payout.

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[5] Response to Consumer Advocate Discovery Request No. 1-117a and b.

[6] Apparently, there are no Tennessee-based employees eligible for Long-Term Incentive Compensation as there are no Long-Term Incentive Compensation costs incurred directly by CGC.

[7] Given the scope and scale of The Southern Company's electricity operations, most of The Southern Company EPS goals will be driven by the financial performance of its electric utility operations. CGC Earnings contribute less than $.01/share for The Southern Company.

Such compensation is designed to benefit shareholders and is not the type of cost that is appropriate to include in the CGC revenue requirement. The adjustment to CGC Labor costs totals $[redacted] while the adjustment to Allocated Costs totals $[redacted]. This adjustment is set forth in Consumer Advocate Schedule No. 4-1. My recommendation to remove these costs is consistent with the TPUC Order approving the Stipulation and Agreement in Docket No. 14-00146, in which Atmos Incentive Compensation costs were removed.[8]

Q15. PLEASE CONTINUE WITH A DISCUSSION OF THE SECOND ADJUSTMENT YOU ARE SUPPORTING REGARDING PENSION AND OPEB COSTS, AS SHOWN ABOVE ON TABLE 1, ADJUSTMENT 2.

A15. This adjustment increases O&M expense for cash pension contributions[9] and reduces O&M for accrued pension and Other Post Employment Benefit (OPEB) costs. The net adjustment reduces O&M costs $[redacted] as set forth in Consumer Advocate Schedule No. 4-2.

Q16. WHAT IS THE RATIONALE FOR THIS ADJUSTMENT TO PENSION AND OPEB COSTS?

A16. This adjustment is consistent with a prior TPUC decision involving a Tennessee American Water Company (TAWC) rate case in Docket No. 08-00039.[10] In that case, TPUC adopted the Cash Contribution Approach to defining Pension Expense rather than the accrued accounting costs proposed by TAWC. More recently, TPUC also adopted the Cash Contribution Approach to determining pension and OPEB costs in Docket No. 14-00146, Atmos' general rate case.

Q17. PLEASE SUMMARIZE YOUR RECOMMENDATION CONCERNING YOUR ADJUSTMENT TO REMOVE GOVERNMENTAL AFFAIRS

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[8] TPUC Order 14-00146 dated November 4, 2015.
[9] When asked in Consumer Advocate Discovery Request No. 1-308, CGC only referenced cash contributions to its pension plan and did not identify any cash contributions to its OPEB plan.
[10] TPUC Order dated January 13, 2009.

LABOR CHARGES AND CERTAIN RELATED CHARGES FROM THE COMPANY'S PROPOSED O&M COSTS, AS SHOWN ON TABLE 1, ADJUSTMENT 3.

A17. This Adjustment eliminates $[redacted] (Marked by the Company as Confidential) in Governmental Affairs labor charges from the Test Period O&M costs, as well as associated benefit costs and a small portion of organizational dues that relate to lobbying. Of the total adjustment amount, $[redacted][11] is allocated from AGSC; $[redacted][12] is allocated to CGC through AGSC from Southern Company Services; $[redacted] is benefit costs associated with the above allocated labor; and $[redacted] relates to the portion of organizational dues related to lobbying.[13] This adjustment is set forth and supported in Consumer Advocate Schedule No. 4-3.

Q18. PLEASE EXPLAIN YOUR RATIONALE FOR ELIMINATING COSTS ASSOCIATED WITH CGC'S AND AGSC'S GOVERNMENTAL AFFAIRS FUNCTION.

A18. The job descriptions associated with these charges were provided by CGC in Consumer Advocate Discovery Request No. 1-41 and were identified by CGC as Confidential.

[redacted]

[11] Response to Consumer Advocate Discovery Request No. 1-141.
[12] Response to Consumer Advocate Discovery Request No. 1-119.
[13] Response to Consumer Advocate Discovery Request No. 1-154.

[redacted]

These tasks are consistent with the Federal Energy Regulatory Commission's (FERC) definition of Account 426.4 "Expenditures for certain civic, political and related activities".[14] This account is considered 'below the line' for ratemaking purposes and therefore should be excluded from the determination of CGC's revenue requirement.

Q19. PLEASE SUMMARIZE YOUR RECOMMENDED ADJUSTMENT TO REFLECT CHANGES TO AGSC'S CORPORATE COST ALLOCATIONS, AS SHOWN ON TABLE 1, ADJUSTMENT 4.

A19. This adjustment reduces the Company's proposed O&M charges, $[redacted], by modifying AGSC's Composite Allocation Ratio. The use of a general allocator is a common practice within the utility industry to assign costs that cannot be allocated using a more specific allocator.

While AGSC's Composite Ratio uses four factors (identified and discussed below), I modify the ratio to exclude one of the four factors AGSC uses in the computation of the ratio, resulting in a reduction in costs allocated from AGSC to CGC.

Q20. WOULD YOU DESCRIBE THE COMPOSITE RATIO AND HOW IS IT USED BY AGSC TO ALLOCATE COSTS?

A20. The AGSC Composite Ratio is a general allocator that is applied to the residual costs of AGSC that are not assigned to affiliates using a more specific allocation

[14] The FERC definition for account 426.4 is as follows: This account shall include expenditures for the purpose of influencing public opinion with respect to the election or appointment of public officials, referenda legislation or ordinances, or approval, modification or revocation of franchises; or for the purpose of influencing the decisions of public officials, but shall not include such expenditures which are directly related to appearances before regulatory or other governmental bodies in connection with the reporting utility's existing or proposed operations. [18] Code of Federal Regulations Chapter 1, Subchapter F, Part 201.

ratio. In this sense it is a 'general' allocator that is applied to those costs that AGSC believes cannot be assigned using another method.

Q21. HOW DOES AGSC CALCULATE THE COMPOSITE RATIO?

A21. The Composite Ratio is the average factors for the following four categories as defined by the ratio of CGC data to total SCG's data: a) total assets, less receivables, b) full time equivalent employees, c) Operating Margin, and d) Operating Expenses.

Q22. PLEASE IDENTIFY WHICH OF THE FACTORS YOU HAVE EXCLUDED.

A22. I have excluded the Operating Expense portion of the Composite Ratio.

Q23. WHY HAVE YOU EXCLUDED THIS FACTOR?

A23. This factor includes a significant level of allocated charges since it is based upon total operating expenses, therefore this allocator is circular in nature. In other words, Operating Expenses include allocated costs and I do not believe it is appropriate to then allocate costs subject to the composite allocator which in part are based upon total allocated costs for the prior quarter. Therefore, I have excluded the operating expense allocator and recalculated the Composite Ratio based upon the average of the three factors for each of the four quarters in 2017.

Q24. DESCRIBE YOUR APPROACH AFTER EXCLUDING THE OPERATING EXPENSE ALLOCATOR.

A24. After excluding the operating expense allocator, I applied the revised Composite Ratio to the total AGSC charges that were subject to the Composite Ratio. The result is a reduction in O&M costs of $[redacted] as set forth on Consumer Advocate Schedule No. 4-4. The recalculated Composite Ratio is shown below in Table 2.

** Note: Chart has been marked Confidential by the Company per Protective Order.

Table 2				
Calculation of Composite Ratio				
A/ 2017	Assets Less Receivables	Full Time Employees	Operating Margin	Average
[redacted]				
A/ CONFIDENTIAL CPAD-1-347h,i,j,&k				

Q25. WERE YOU ABLE TO VERIFY THE ACCURACY OF THE COMPOSITE RATIO USED BY AGSC?

A25. No. I have not able to confirm the accuracy of AGSC Composite Ratio.

Q26. WHY WERE YOU UNABLE TO CONFIRM THE ACCURACY OF AGSC'S COMPOSITE RATIO?

A26. A number of SCG's entities have been excluded from the development of the Composite Ratio, due to very little or no commercial operations according to CGC.[15]

Q27. ARE YOU CONCERNED WITH THE NUMBER OF ENTITIES EXCLUDED FROM THE DEVELOPMENT OF THE COMPOSITE RATIO?

A27. Yes. My concern is that SCG (or AGSC) may exclude certain competitive enterprises in the development of allocation ratios to assign more costs to

[15] See response to Consumer Advocate Discovery Request No 1-347.

regulated entities, including CGC. Entities that are excluded from AGSC's Composite Ratio are not assigned common costs, therefore leaving more costs assigned to regulated entities such as CGC.[16]

To illustrate my concern, in response to Consumer Advocate Request No. 1-356, a sample of seven nonregulated entities were selected and their financial statements requested to determine whether in fact they had little or no commercial activity. After an initial objection and much discussion, the requested information was provided on June 11, 2018. [redacted] This concern then extends to the other non-regulated (competitive) entities that are also excluded from receiving composite cost allocations. I will discuss additional deficiencies related to the Company's Cost allocation process later in my testimony.

** Note: Chart was marked Confidential by the Company per Protective Order.

Table 3

	Affiliate Sampled
[redacted]	

**

[16] I specifically reserve the right to amend my testimony given the late filing of compelled responses to Consumer Advocate Discovery Request No. 1-400.

Q28. PLEASE DESCRIBE YOUR ADJUSTMENT TO O&M COSTS RELATED TO THE ATTRITION PERIOD, AS SHOWN ON TABLE 1, ADJUSTMENT 6.

A28. This adjustment increases O&M costs $[redacted] to move the Consumer Advocate adjusted Test Period costs to the Attrition Period.

Q29. PLEASE EXPLAIN HOW YOU CALCULATED THE ATTRITION PERIOD FACTORS USED WITHIN YOUR ADJUSTMENT.

A29. Three inflation factors were developed, including labor, customer growth and a composite growth factor. The labor growth factor was calculated based upon the two-year average growth in CGC O&M labor costs. This factor was then doubled to reflect the estimated growth in the two-year period between 2017 to the 2019 Attrition Period. The customer growth factor was developed by Mr. Novak and described in his testimony. The Consumer Advocate's Composite Factor was developed based upon the annual average 2018 CPI factors developed by CGC in Minimum Filing Guidelines (MFG) No. 43. This annual factor was then doubled to reflect the two-year period between the Test Period and the Attrition Period.

Q30. HOW DID YOU APPLY TEST PERIOD COSTS TO THE ATTRITION PERIOD FACTORS?

A30. The Test Period O&M costs were classified into one of the three categories, the labor factor was then applied to CGC direct labor, the customer growth factor was applied to Customer related O&M costs, and the composite growth factor was applied against the remainder of the Consumer Advocate adjusted Test Period O&M expenses. The result is an increase in O&M costs of [redacted] to estimate the Attrition Period O&M costs based upon the Consumer Advocate adjusted Test Period.

Q31. IN ADDITION TO THE ADJUSTMENTS YOU RECOMMENDED EARLIER, ARE THERE ANY OTHER SIGNIFICANT DIFFERENCES BETWEEN YOUR ATTRITION PERIOD COSTS AND THOSE PROPOSED BY CGC?

A31. Yes. One significant difference is the CGC assumption that it would increase its Tennessee-based employee count by 25% between the Test Period and its Attrition Period. Table 4 below shows the difference between the Consumer Advocate's adjusted Attrition Period and that included by CGC in this filing:

Table 4 - Summary of Attrition Period Payroll Expense

	A/			B/		
	CPAD Test Period FYE 12-31-17	[redacted]	CPAD Attrition Period FYE 12-31-19	CGC Attrition Period FYE 6-30-19		CPAD - CGC Difference
Payroll Expense	$ 3,010,584		$ 2,929,318	$ 3,537,716		$ (608,398)

A/ CPAD Exhibit, Schedule 9-12
B/ CGC TPUC MFG 25 All Attachments and Tucker Exhibits Rev 6-1-2018, Tab O&M

History suggests the 25% increase in CGC labor is an unrealistic assumption and one that appears to be an attempt to increase the revenue requirement without any real substance. CGC points to the aging work force; however, gas utilities have faced this issue for some time now without such a large increase. Further, new employees tend to be compensated less than retiring employees.[17] The situation of an aging workforce may be a temporary challenge, but not one that justifies an extraordinary permanent increase in the forecasted CGC labor count significantly in excess of historic employment levels.

Table 5 as shown below highlights the consistent employment levels of CGC contrasted with the number of budgeted employees assumed as of December 31, 2018.[18]

[17] For a comparison of the per employee costs associated with new hires compared with retirees, compare the Company's responses to Consumer Advocate Discovery Request Nos. 1-139. and 1-140.
[18] The Consumer Advocate would point out that utilities have strong incentives to inflate budgeted costs within its Attrition Period in the context of a rate case.

Table 5		
Comparison of Actual and Budgeted Employee Count		
A/		
Period	Actual Employees	Budgeted Employees
12/31/2012	39	41
12/31/2013	40	42
12/31/2014	39	40
12/31/2015	38	39
12/31/2016	39	39
12/31/2017	40	45
12/31/2018	N/A	50
A/	Response to CPAD DR 1-122	

III. ATTRITION PERIOD TAXES OTHER THAN INCOME TAXES

Q32. PROVIDE A SUMMARY OF YOUR RECOMMENDATIONS REGARDING TAXES OTHER THAN INCOME TAXES.

A32. The Test Period balances of taxes were determined, and appropriate factors were applied to calculate the Attrition Period balances. The majority of Taxes Other than Income Taxes are comprised of Property Taxes. Other components include TPUC Inspection Fees, Payroll Taxes, Franchise Taxes and Gross Receipts Tax.

Q33. EXPLAIN HOW YOU ARRIVED AT THE ATTRITION YEAR BALANCES.

A33. The Test Period balances of Taxes Other than Income Taxes were determined as set forth on Consumer Advocate Schedule No. 10-1. The Test Period balances were increased using growth factors related to each tax item. Property Taxes were increased over the two-year period based upon the forecasted growth in plant. State Gross Receipts Taxes and State Franchise Taxes were increased based upon the growth in forecasted Attrition Period revenue compared to Test Period revenue. Net Payroll Taxes were increased based upon the forecasted growth in

payroll over the two-year period, and the TPUC Inspection Fees were increased using the composite attrition period factor based upon CGC's CPI factors. The resulting adjustment in Test Period costs is $293,184 as identified in Consumer Advocate Schedule No.10-1.

IV. ATTRITION PERIOD CASH WORKING CAPITAL

Q34. PLEASE PROVIDE A SUMMARY OF YOUR RECOMMENDATIONS CONCERNING CASH WORKING CAPITAL.

A34. My Cash Working Capital (CWC) calculation excludes the Return on Equity from the balance of Operating Expenses subject to calculating the Daily Cost of Service. The Daily Cost of Service is then applied to the Net Lag Days to determine the CWC required for Operating Expenses. My adjustment also incorporates the test period average balance of Tax Collections Withheld.

Q35. PLEASE PROVIDE AN OVERVIEW OF CWC, HOW IT IS DETERMINED AND HOW IT IMPACTS THE DETERMINATION OF A UTILITIES' REVENUE REQUIREMENT.

A35. CWC is a measurement of the amount of cash a company requires to have on hand to fund day-to-day operations. The most precise method of determining CWC is through the use of a lead-lag study, such as the one presented by CGC witness Adams in this case. A CWC study measures the timing between when revenue is earned and when it is received, when cash expenses are incurred and when they are paid. These measurements are netted to determine the amount of funding required to provide utility service. This level of funding, or investment is appropriately included as a component of Rate Base. The level of CWC in Rate Base may be positive or negative depending upon the outcome of the study.

Q36. WHAT IS THE AMOUNT OF CWC YOU ARE SUPPORTING AS AN ADJUSTMENT TO CGC RATE BASE?

A36. Consumer Advocate Schedule No. 5 sets out the Net CWC required of $150,702. This compares with a CGC request to increase Rate Base $1,521,871.

Q37. YOU MENTION ABOVE THAT YOU HAVE REMOVED RETURN ON EQUITY IN THE CALCULATION OF DAILY OPERATING EXPENSES THAT THEN ARE USED TO COMPUTE THE BALANCE OF CWC – PLEASE EXPLAIN YOUR RATIONALE.

A37. First, Return on Equity is a non-cash expense that does not generate a cash requirement on behalf of CGC or The Southern Company. The payment of shareholder dividends is optional, and the vast majority of Net Income is retained by the Company. If dividends are paid, they are done so in arrears, with a significant expense lag. This lag has not been factored into Mr. Adams' analysis, assuming a conclusion that some aspect of Return on Equity represented a requirement to outlay cash to fund operations. Finally, investors recognize that the receipt of cash associated with Return on Equity is not instantaneous and that any such delays are already factored into shareholder expectations.

The purpose of a lead lag study is to determine the cash necessary to fund operating expenses. The Return on Equity is neither a cash item, nor an operating expense and it does not qualify as a component of the cash working capital study.[19]

Q38. HAS TPUC ADOPTED A CWC CALCULATION EXCLUDING EQUITY FROM THE CALCULATION OF DAILY OPERATING EXPENSES?

A38. Yes. The Commission adopted a Stipulation and Agreement in Docket No. 12-00049, a Tennessee American Water Company rate case that excluded Return on

[19] I have not excluded other non-cash items from the CWC study, such as Depreciation Expense and Deferred Taxes, and I believe the exclusion of these items may be warranted in future studies after further consideration.

Equity costs from the calculation of Daily Operating Expenses, and therefore it was completely excluded from determination of CWC in that case.

Q39. ARE YOU AWARE OF OTHER STATE REGULATORS' ORDERS SUPPORTING THE EXLCUSION OF RETURN ON EQUITY FROM THE DETERMINATION OF THE CWC CALCULATION?

A39. Yes. The Return on Equity component was not included in lead lag study, by the Illinois Commerce Commission in a Nicor Gas Company rate case.[20] Likewise, the Return on Equity component was not included in the CWC calculation of Kansas Gas Service in Docket No. 06-KGSG-1209-RTS.

In a case before the Hawaii Public Utilities Commission[21], the Commission found:

> Return on common equity does not represent any expenses incurred in providing service to which any revenue relates. Thus, **return on common equity is excluded from consideration in computing working cash.** (emphasis added.)[22]

Q40. IS THERE ANY OTHER SIGNIFICANT DIFFERENCE BETWEEN CGC'S CALCULATION OF CASH WORKING CAPITAL REQUIREMENTS AND THE METHOD SUPPORTED IN CONSUMER ADVOCATE SCHEDULE NO. 5?

A40. Yes. The other area of difference is in the determination of the working capital provided from Franchise, Sales and Use taxes. These are items that are collected from CGC ratepayers and later remitted by the Company to appropriate taxing authorities. The retention of these funds prior to remittance provides a source of ongoing working capital for the Company. I have relied upon the use of the Test Period average balance of these liability accounts to quantify the amount of funds available to CGC. This method is identical to that used to determine the gas

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[20] Illinois Commerce Commission Docket No. 17-0124.
[21] *In Re Hawaii Electric Light Company, Inc.*, 120 P.U.R. 4th 427 (Haw. Pub. Util. Comm'n, March 6, 1991).
[22] The Process of Ratemaking, Vol. II, Leonard Saul Goodman, Public Utilities Reports, Inc.

inventory portion and Materials and Supplies components of rate base and therefore provides for consistency.

V. ACCUMULATED DEFERRED INCOME TAXES AND TCJA AMORTIZATION

Q41. PLEASE SUMMARIZE YOUR RECOMMENDATION REGARING ACCUMULATED DEFERRED INCOME TAXES, THE TCJA AND ITS IMPLICATIONS ON THE REVENUE REQUIREMENT OF CGC.

A41. I am recommending that the Tax Savings accruing for the period January 1, 2018 through September 30, 2018 resulting from the reduction in the federal tax rate from 35% to 21% be amortized and returned to CGC ratepayers over a three-year period. Similarly, the excess ADIT resulting from the tax rate reduction should be returned to CGC ratepayers over a three-year period. The amortization of the balances of both the tax savings and the excess ADIT should not begin until new base rates in this case become effective.

Q42. PLEASE BEGIN BY PROVIDING SOME BACKGROUND INFORMATION ON THE TAX CUTS AND JOBS ACT.

A42. In December, 2017 the President signed the Tax Cuts and Jobs Act into law. The new legislation lowered the federal tax rate for corporations from 35% to 21% effective January 1, 2018. This reduction in the federal tax rate has significant implications for balances of Accumulated Deferred Income Taxes (ADIT), an important source of cost-free capital for utilities. These deferred income taxes arise from the difference in determination of taxable income compared with book income calculated consistent with Generally Accepted Accounting Principles

(GAAP). The single largest difference[23] in these two measures of income is the determination of depreciation. Accelerated tax depreciation, including the use of bonus depreciation,[24] is used to reduce taxable income, while book income incorporates much lower depreciation rates.

Q43. HOW DOES THIS DIFFERENCE BETWEEN BOOK INCOME AND TAXABLE INCOME AFFECT THE CACULATION OF ADIT?

A43. This cumulative[25] difference between taxable and book income is then applied against the composite federal and state income tax rate,[26] and the result is the balance of ADIT[27]. Income tax expense included in regulated utility rates is determined based upon the higher level of book income, therefore the balance of deferred taxes reflects amounts of expense incurred by the utility and collected from ratepayers, but which will not be paid in the form of current tax expense until some point in the future. Thus, deferred taxes are a source of cost-free capital that utilities may use to fund capital investment and is used to reduce rate base in the rate-setting process.

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[23] There are other differences in the measurement of the two income levels. Generally, taxable income relies more on cash expenses, while book income incorporates accrued expenses.

[24] Bonus depreciation has been in effect for a number of years; however, the TCJA prohibits the use of bonus depreciation for utilities beginning in 2018.

[25] The cumulative difference is measured as a running total of these book and tax differences.

[26] The composite tax rate is 26.135% and reflects the 6.5% state tax rate and the 21% statutory federal tax rate. Since state taxes are deductible for purposes of calculating federal tax expense, the composite rate is less than the sum of the two rates.

[27] The cumulative book and tax differences are multiplied by the composite tax rate in arriving at the balance of ADIT.

Q44. WHAT EFFECT DOES THE REDUCTION IN THE FEDERAL TAX RATE HAVE ON THE BALANCE OF ADIT?

A44. The balance of ADIT is a function of the composite federal/state tax rates. Therefore, since the federal tax rate was significantly reduced, the balance of ADIT is reduced accordingly. However, the ADIT balance (pre-TCJA) reflects the collection of income tax expense accrued by utilities, but which will not be paid until some point in the future. Ratepayers fund these tax pre-payments and therefore have a claim on the balance of ADIT that is reduced as a result of the reduction in the federal income tax rate.

Q45. HAS THE TENNESSEE PUBLIC UTILITY COMMISSION IDENTIFIED THE REDUCTION IN ADIT ARISING FROM THE TCJA AS A REGULATORY ISSUE IN ANY DOCKET?

A45. Yes. TPUC addressed this point in Docket No. 18-00001 when it required utilities to calculate the excess deferred tax reserve caused by the reduction in the corporate federal income tax rate.[28] TPUC further required this excess balance be captured as a deferred liability on the books of Tennessee's largest investor-owned utilities, in order to accurately measure the ongoing cost-free capital provided by ratepayers.[29] This excess ADIT reflects the reduction in the liability balance that results from the reduction in the composite rate due to the federal tax rate change.

[28]TPUC Docket No. 18-00001, TPUC Order Opening an Investigation and Requiring Deferred Accounting Treatment, Order dated February 6, 2018.
[29] TPUC Docket No. 18-0001.

Q46. IS THERE A SPECIFIC DOCKET SET UP TO ADDRESS REGULATORY ISSUES SURROUNDING THE TCJA FOR CGC?

A46. Yes. TPUC Docket No. 18-0035 was initiated to address the regulatory implications of the TCJA on CGC.

Q47. DID CGC SUPPORT THE CONCEPT OF ADDRESSING ALL TCJA IMPACTS IN ITS PENDING RATE CASE?

A47. Yes.

Q48. HAS CGC COMPLIED WITH THIS PORTION OF THE TPUC REQUEST?

A48. CGC has only partially complied with this requirement. Effective with the TCJA implementation in late December, 2017, CGC has identified its excess ADIT balance and moved it to a regulatory liability balance. However, at least for purposes of this case, CGC has begun to amortize its excess ADIT balance,[30] which is not in compliance with the TPUC order and which has negative implications for CGC ratepayers which I will discuss later in my testimony.

Q49. DOES THE TCJA CONTAIN REQUIREMENTS FOR HOW REGULATORS MUST TREAT EXCESS ADIT WITHIN THE RATEMAKING PROCESS?

A49. The TCJA requires specific treatment for the portion of excess ADIT, known as "Protected". "Protected" excess ADIT relates to property-related book and tax timing differences and the TCJA requires that such excess be amortized over the life of the collective assets giving rise to the ADIT using one of two amortization

[30] It is unclear whether CGC has begun the amortization on its books that is reflected in its Amended MFG 69-13.

methods[31]. Excess ADIT balances related to timing differences other than property, referred to as "Unprotected", may be addressed at the discretion of state regulatory commissions, including TPUC. "Unprotected" ADIT is essentially all other book and tax timing differences other than those related to property.

Q50. DO YOU BELIEVE THE IMPACTS OF THE TCJA MAY BE ADDRESSED FOR CGC WITHIN THIS RATE CASE FILING?

A50. Yes.

Q51. CAN YOU PLEASE LIST THE REVENUE REQUIREMENT IMPLICATIONS OF THE TCJA?

A51. Yes. Implications of the TCJA on the CGC revenue requirement include:

1. Reduction in the federal income tax rate from 35% to 21% effective with the implementation of new base rates.

2. Identification of Excess ADIT further split between the "Protected" and "Unprotected" categories.

3. Annual Amortization expense calculation of the "Protected" excess ADIT associated with property-related book tax timing differences.

4. Period used to amortize excess "Unprotected" ADIT as a reduction to Operating Expenses.

5. The timing of amortizing all excess ADIT, which impacts the Attrition Period balance of unamortized ADIT as a rate case component.

[31] The two methods are the Average Rate Assumption Method and the Reverse South Georgia Method. In both approaches the objective is to amortize the "Protected" Excess ADIT over the life of the remaining assets.

6. The proposal by CGC to retain tax expense saving for the period between January 1, 2018 and the date new rates become effective.

Q52. REFERRING TO THE ABOVE LIST, ARE THERE ASPECTS OF THE TCJA FOR WHICH YOU AGREE WITH THE METHODS USED BY CGC?

A52. Yes. I agree with CGC's treatment of the following aspect of the TCJA:

1. Reduction in the federal income tax rate from 35% to 21% effective with the implementation of new base rates. This issue is the single most significant aspect of the TCJA and I agree with the use of the lower tax rate as used by CGC within its Income Tax Expense calculations for purposes of setting rates on a going forward basis.

2. Identification of Excess ADIT further split between the "Protected" and "Unprotected" categories. I have reviewed the determination of excess ADIT and have no objection with CGC's calculation of the deferred liability and the resulting lower ADIT balance.[32] I further have no objection with the CGC calculated determination of the "Protected" and "Unprotected" portions of the excess ADIT (deferred regulatory liability).

3. Annual Amortization expense calculation of the "Protected" excess ADIT associated with property-related book tax timing differences. I have no objection with CGC's amortization of excess "Protected" ADIT. This amortization results in a credit to pro-forma Income Tax Expense over the life of the assets, thus reducing the revenue requirement.[33] However, I disagree with the

[32] Supplemental Response to Consumer Advocate Discovery Request No. 1-374.
[33] Of the total Amortization of Deferred Tax Liability per CGC of $897,742 as shown on RDJ No.1-3 (revised in MFG No. 25), $397,482 relates to "Protected" Excess ADIT (MFG No. 69-13 revised).

timing of this amortization as CGC has initiated amortization in advance of approval by TPUC as I will discuss below.

Q53. AGAIN, REFERRING TO THE LIST ABOVE, ARE THERE ASPECTS OF CGC IMPLEMENTATION OF THE TCJA WITH WHICH YOU DISAGREE?

A53. Yes. Identified below are aspects of CGC's implementation of the TCJA with which I disagree.

1. Period used to amortize excess "Unprotected" ADIT as a reduction to Operating Expenses. CGC proposes to amortize its balance of "Unprotected" ADIT to the cost of service over a five-year period. Ironically, CGC has proposed a five-year amortization period for the amortization of rate case expense, an item that increases the revenue requirement. I propose using a three-year amortization period. These amounts belong to ratepayers, justifying a shorter amortization period. Further, the three-year period is consistent with the period used to amortize rate case costs. The use of a three-year amortization period reduces O&M costs $253,143 as shown on Consumer Advocate Schedule No. 11-1.2, compared with the use of a five-year amortization period.

2. The timing of amortizing all excess ADIT, which impacts the Attrition Period balance of unamortized ADIT as a rate case component. CGC has reflected its Attrition Period balance of its unamortized excess ADIT balance. I do not object to the proposal that the unamortized excess ADIT balance reflects cost-free capital that is properly included as a rate base deduction. However, CGC has prematurely begun amortizing and retaining these benefits as of December,

2017,[34] thus reducing its unamortized balance. Rather than initiating the amortization of the excess ADIT[35] as of December, 2017, I recommend TPUC require initiating of the amortization to begin as of the effective date of new base rates in this case. In this way, CGC ratepayers receive the full benefit of the excess ADIT. CGC has begun amortizing ADIT which translates to retention of the benefits of the TCJA for its shareholders to the detriment of its ratepayers. Further, such amortization of excess ADIT balances is not provided for in the TPUC order initiating an investigation in Docket No. 18-00001. The amortization of both components of excess ADIT should commence with the implementation of base rates. In this manner, the ratemaking impact of TCJA is synchronized with new base rates. CGC should not be permitted to retain any portion of the excess ADIT, which would occur if this adjustment is not adopted.

3. The proposal by CGC to retain tax expense saving for the period between January 1, 2018 and the date new rates become effective. TPUC established Docket No. 18-00035 as the federal tax reform compliance docket for CGC. On March 29, 2018, CGC submitted comments indicating that since it has historically underearned its authorized return on equity it should be permitted to retain the tax savings resulting from the reduced federal income tax rate effective January 1, 2018. I take exception to this proposal for several reasons. First, the tax savings at issue are generated in 2018. CGC argues[36] that its financial results for the prior twelve-month average were below its authorized rate of return, thus it

[34] See CGC MFG No. 69-13 revised May 31, 2018.
[35] As discussed above the "Protected" portion of excess ADIT is to be amortized over the life of the assets, while CGC is amortizing its excess "Unprotected" ADIT over a five-year period.
[36] CGC Compliance Filing and Report, TPUC Docket No. 18-00035, page 2.

should be permitted to retain the tax savings. The attribution of 2018 tax savings to 2017 financial results represents a mismatch of accounting periods. Further, the application of savings accruing in 2018 due to financial results occurring in 2017 implies rates were unjust and unreasonable. The CGC proposal to attribute 2018 savings to 2017 financial results could be interpreted as retroactive ratemaking,[37] which is the setting of rates to permit a regulated entity from recovering past losses.

Secondly, as evidenced by this filing, there is a broad difference of opinion on the regulatory earnings of CGC. Putting aside the potential problem with the retroactive application of 2018 tax savings to 2017 results, I do not believe there is clear evidence that CGC was under-earning during the period in question. The Consumer Advocate has presented evidence in this Docket that CGC has not justified the need for a rate increase.[38]

Finally, the retention of tax savings in 2018 was not provided for within the TPUC Order opening its investigation. There is no language in the Order providing for the retention of 2018 tax savings if a showing of under-earnings was demonstrated.

Q54. WHAT IS YOUR RECOMMENDATION FOR THE REGULATORY TREATMENT THAT SHOULD BE AFFORDED CGC'S INCOME TAX EXPENSE SAVINGS ACCRUING IN 2018?

[37] One example of retroactive ratemaking is the recovery of past losses in rates charged in the future. This is consistent with the argument made by CGC to apply 2018 tax savings to (alleged) 2017 earnings deficiencies.
[38] Please see Mr. Novak's testimony with respect to CGC's claim of over-earning and related data.

A54. I believe such savings should be estimated and returned to CGC ratepayers over a three-year period through a credit to a specific Regulatory Amortization Expense. The unamortized balance of these tax savings represents a source of cost-free capital and should be used to reduce rate base. I have estimated the amount of tax savings accruing through September, 2018 at $560,961.[39]

Q55. HOW DID YOU ESTIMATE THE AMOUNT OF TAX SAVINGS ACCRUING DURING 2018?

A55. I obtained the Income Tax Expense component included in base rates in the last CGC base rate proceeding, TPUC Docket No. 09-00183. This Income Tax Expense component was dependent upon the composite tax rate in effect during that period. Using both the Income Tax Expense component and the composite tax rate I was able to compute the taxable income amount incorporated within the revenue requirement. I then applied the new composite tax rate to the computed taxable income to arrive at a pro-forma level of Income Tax Expense. The difference between the previously authorized Income Tax Expense component and the pro-forma amount of Income Tax Expense reflects an annual level of Income Tax Expense savings attributed to the reduced federal income tax rate. For purposes of this Docket, I assumed new tariff rates as ordered by the Commission would become effective on October 1, 2018, which would then include the reduced federal income tax rate, therefore I reduced the annual tax savings to reflect over-collection of Income Tax Expense for nine months of 2018. I then

[39] If rates resulting from this case are implemented on a different date, this tax savings calculated would change accordingly.

amortized the resulting balance over a three-year period to calculate the appropriate credit to the revenue requirement.

The calculation is summarized in Table 6 below.

Table 6

Line No.	Calculation of 2018 Tax Savings Estimated Through September, 2018		
1	Income Tax Expense Component built into Base Rates Docket 09-00183	$2,241,272	
2	Total State and Federal Effective Rate - Docket 09-00183	39.225%	
3	Calculated Taxable Income from Docket 09-00183		$5,713,887
4	Current Composite Federal and State Income Tax Rate	26.135%	
5	Pro-Forma Income Tax Expense - 2018 (Line 3 * Line 4)		$1,493,324
6	Current Annualized Tax Savings (Line 1 - Line 5)	$ 747,948	
7	Estimated Portion of Savings - January - September, 2018 (Line 6 * 9 / 12)	**$ 560,961**	

This calculation is also shown on Consumer Advocate Schedule No. 11-3.

Q56. HOW DID YOU DETERMINE THE APPROPRIATE REDUCTION TO RATE BASE ASSOCIATED WITH THE UNAMORTIZED TAX SAVINGS DEFERRAL?

A56. Once the total tax savings were determined, I amortized the balance over a three-year period, starting with the estimated date of new base rates, October 1, 2018. My adjustment to reduce rate base was based upon the average unamortized balance during the 2019 Attrition Period. This balance is reflected on Consumer Advocate Schedule No. 11-1.

Q57. ARE YOU SUPPORTING ANY ADJUSTMENTS TO THE BASE LEVEL OF ADIT PROPOSED BY CGC IN ITS ATTRITION PERIOD?

A57. No.

VI. ACCOUNTING POLICY CONCERNS AND RECOMMENDATIONS

Q58. AT THE OUTSET, PROVIDE SOME CONTEXT ON THE MAGNITUDE OF COSTS ALLOCATED TO CGC RELATIVE TO ITS TOTAL O&M COSTS.

A58. In 2017, CGC incurred affiliate charges of $5,229,945,[40] compared with total 2017 O&M costs of $12,067,183,[41] excluding purchased gas costs.[42] Therefore, these affiliate charges are a major component of total CGC O&M charges.

Q59. WHAT ENTITY PROVIDES THESE AFFILIATE SERVICES TO CGC AND WHAT IS THE SCOPE OF COSTS INCURRRED BY THIS AFFILIATE?

A59. In 2017, AGSC allocated a total of $274,687,176[43] to affiliates of SCG, including CGC.

Q60. COULD YOU PLEASE SUMMARIZE YOUR CONCERNS WITH THE PROCESS USED TO ALLOCATE COSTS TO CGC?

A60. There is a significant lack of transparency and documented processes supporting the cost allocation methodology that I would expect from a very large regulated entity such as The Southern Company. This shortcoming has driven the need for a

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[40] Response to Consumer Advocate Discovery Request No. 1-41.
[41] See Consumer Advocate Schedule No. 9-13.
[42] Purchased gas expense is not an element of the revenue requirement calculation and therefore is not included in base rates.
[43] Response to Consumer Advocate Discovery Request No. 1-41.

significant amount of discovery in this Docket. The lack of transparency prevents the Consumer Advocate from drawing conclusions on the reasonableness of the allocated charges. The lack of emphasis in maintaining necessary documentation supporting affiliate transactions within a company the size of SCG[44] appears to be a corporate strategy designed to prevent the Consumer Advocate and regulators from fully evaluating these charges.

Q61. DOES SOUTHERN COMPANY GAS HAVE A COST ALLOCATION MANUAL (CAM) WHICH DOCUMENTS THE PROCESSES AND METHODOLOGIES USED IN ALLOCATING COSTS TO ITS ENTITIES?

A61. No.[45]

Q62. WHAT IS THE PURPOSE OF A CAM?

A62. The purpose of a CAM for a regulated entity is two-fold. First, it provides formal specific guidance to employees on the procedures to follow in tracking costs and allocating such costs to the appropriate organization. The existence of the manual, along with periodic training and reinforcement, signifies that compliance with documented procedures is a priority. Secondly, the CAM should be used to support the reasonableness of such allocation methodologies and processes before state regulators. The lack of a CAM raises questions as to whether either of these objectives is a priority within SCG.

Q63. WHAT IS YOUR RECOMMENDATION TO TPUC CONCERNING THE LACK OF DOCUMENTATION SUPPORTING THE PROCEDURES

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[44] My comments are focused on SCG as the vast majority of costs allocated to CGC are incurred at the AGSC level. There are some costs flowing from the Southern Company Services entity that flow to AGSC and then on to CGC, but these costs are relatively minor at the CGC level.

[45] Response to Consumer Advocate Discovery Request No. 1-12.

RELIED UPON BY AGSC IN ALLOCATING COSTS TO ITS AFFILIATES?

A63. I recommend TPUC require future CGC cost allocations to be supported by a fully transparent and documented CAM.

Q64. WHAT IS THE REGULATORY CONCERN REGARDING AFFILIATED TRANSACTIONS WITHIN AN ORGANIZATION THAT HAS SIGNIFICANT NON-REGULATED ENTITIES?

A64. Entities of the size and scope of the Southern Company (and separately SCG) can maximize overall corporate profitability by adopting cost allocation methods and processes that limit the amount of common costs assigned to competitive, non-regulated entities, resulting in relatively more costs assigned to entities providing monopoly services to captive customers. This concern is heightened as a result of the number of non-regulated entities within SCG.

Q65. WHAT ARE THE ESSENTIAL COMPONENTS OF A CAM THAT YOU ARE RECOMMENDING?

A65. The CAM should contain the following sections:

1. Corporate organization chart identifying all entities within the overall corporate organization. Each listed entity should have a description of the scope of business operations. There should be a complete explanation supporting the reason not to allocate costs to certain affiliate entities.

2. Method used to assign costs; specifically, that costs should be direct charged whenever possible. For those costs that cannot be direct charged, such as those associated with a customer call center should be assigned based upon causal

allocators. Finally, those costs that cannot be neither directly assigned, nor causally allocated should be allocated based upon a composite allocation factor.

3. Matrix that matches cost centers or accounts and the method(s) used to allocate costs by cost allocation method.

4. Quarterly update to allocation ratios. The allocation ratios should be updated quarterly as updated and revised data becomes available that is then used to recalculate the associated allocation ratios.

As mentioned in item 4, the CAM is a document that is constantly changing and being updated. Maintaining and ensuring compliance with a CAM requires focus; however, given the magnitude of corporate costs subject to allocation such effort is necessary to ensure accuracy and provide assurance that such material cost assignments between affiliates are justified.

Q66. ARE YOU AWARE OF ANY OTHER TENNESSEE JURISDICATIONAL UTILITIES THAT HAVE A CAM?

A66. Yes. Atmos Energy Corporation maintains a CAM provided in response to Consumer Advocate Request No. 3-13 provided in TPUC Docket No. 17-00091. While the Atmos CAM does not contain all of the reference material listed above, it does contain some of the information and the existence of such an updated[46] Service Agreement indicates such cost allocation processes are a corporate priority.

Q67. DID CGC PROVIDE A SERVICE AGREEMENT WHICH IT INDICATED GUIDED THE COST ALLOCATION PROCESS?

[46] The date of the Atmos CAM is April 1, 2017.

A67. Yes. The response to Consumer Advocate Request No. 1-13 indicated that such affiliate services were provided by AGSC to CGC through a Service Agreement.

Q68. DID YOU FIND THE REFERENCED SERVICE AGREEMENT TO BE SUFFICIENT TO PROVIDE CONFIDENCE IN THE COST ALLOCATION PROCESS?

A68. No. First, the Service Agreement was entered in 2006, a time when the corporate structure that CGC operated in is significantly different than today. The Service Agreement (Agreement) contains none of the information listed above that should be contained in a CAM. Further, there is a lack of identification of methodologies that are consistently used and documented in the cost allocation process

Q69. DID YOU EVALUATE COMPLIANCE WITH THE AGREEMENT?

A69. Yes. CGC was unable to document communication between the parties as is required in the Agreement,[47] nor is it using types of allocators identified in the Agreement.[48] The age of the Agreement, including the fact that it had not been updated, coupled with the lack of compliance with the Agreement suggests the Agreement is not being relied upon by Southern Company Gas employees and is not serving a useful purpose.

VII. FAILURE TO PROVIDE CLEAR METHODS OF CALCULATING RATE COMPONENTS

Q70. DO YOU HAVE OTHER CONCERNS WITH RESPECT TO THE COMPANY'S ALLOCATIONS, AND SUPPORT SET OUT IN THIS GENERAL RATE CASE?

[47] See response to Consumer Advocate Discovery Request No. 1-348.
[48] See response to Consumer Advocate Discovery Request No. 1-355.

A70. Yes. I have concerns about whether CGC's accounting data may be reasonably relied upon given the lack of sufficient documentation. The complexity of The Southern Company organization, the lack of transparency regarding the scope of unregulated operations, and the lack of CAM documentation coupled with the magnitude of affiliate cost allocations is an additional source of concern. In view of these issues, in my opinion CGC has failed to set forth the necessary practices and procedures for determining ongoing O&M costs. The lack of documentation does not demonstrate that CGC and SCG has sufficient controls in place to provide assurance that cost allocations to regulated operations are reasonable.

Q71. DOES THIS CONCLUDE YOUR TESTIMONY?

A71. Yes, but I reserve the right to amend or clarify my testimony if additional information or facts become available.

Exhibit DND-1

David Dittemore

Experience

Areas of Specialization
Approximately thirty-years experience in evaluating and preparing regulatory analysis, including revenue requirements, mergers and acquisitions, utility accounting and finance issues and public policy aspects of utility regulation. Presented testimony on behalf of my employers and clients in natural gas, electric, telecommunication and transportation matters covering a variety of issues.

Tennessee Attorney General's Office; **Financial Analyst September, 2017 – Current**
Responsible for evaluation of utility proposals on behalf of the Attorney General's office including water, wastewater and natural gas utility filings. Prepare analysis and expert witness testimony documenting findings and recommendations.

Kansas Gas Service; **Director Regulatory Affairs 2014 – 2017; Manager Regulatory Affairs, 2007 - 2014**
Responsible for directing the regulatory activity of Kansas Gas Service (KGS), a division of ONE Gas, serving approximately 625,000 customers throughout central and eastern Kansas. In this capacity I have formulated strategic regulatory objectives for KGS, formulated strategic legislative options for KGS and led a Kansas inter-utility task force to discuss those options, participated in ONE Gas financial planning meetings, hired and trained new employees and provided recommendations on operational procedures designed to reduce regulatory risk. Responsible for the overall management and processing of base rate cases (2012 and 2016). I also played an active role, including leading negotiations on behalf of ONE Gas in its Separation application from its former parent, ONEOK, before the Kansas Corporation Commission. I have monitored regulatory earnings, and continually determine potential ratemaking outcomes in the event of a rate case filing. I ensure that all required regulatory filings, including surcharges are submitted on a timely and accurate basis. I also am responsible for monitoring all electric utility rate filings to evaluate competitive impacts from rate design proposals.

Strategic Regulatory Solutions; 2003 -2007
Principal; Serving clients regarding revenue requirement and regulatory policy issues in the natural gas, electric and telecommunication sectors

Williams Energy Marketing and Trading; 2000-2003
Manager Regulatory Affairs; Monitored and researched a variety of state and federal electric regulatory issues. Participated in due diligence efforts in targeting investor owned electric utilities for full requirement power contracts. Researched key state and federal rules to identify potential advantages/disadvantages of entering a given market.

MCI WorldCom; 1999 - 2000

Manager, Wholesale Billing Resolution; Manage a group of professionals responsible for resolving Wholesale Billing Disputes greater than $50K. During my tenure, completed disputes increased by over 100%, rising to $150M per year.

Kansas Corporation Commission; 1984- 1999

Utilities Division Director - 1997 - 1999; Responsible for managing employees with the goal of providing timely, quality recommendations to the Commission covering all aspects of natural gas, telecommunications and electric utility regulation; respond to legislative inquiries as requested; sponsor expert witness testimony before the Commission on selected key regulatory issues; provide testimony before the Kansas legislature on behalf of the KCC regarding proposed utility legislation; manage a budget in excess of $2 Million; recruit professional staff; monitor trends, current issues and new legislation in all three major industries; address personnel issues as necessary to ensure that the goals of the agency are being met; negotiate and reach agreement where possible with utility personnel on major issues pending before the Commission including mergers and acquisitions; consult with attorneys on a daily basis to ensure that Utilities Division objectives are being met.

Asst. Division Director - 1996 - 1997; Perform duties as assigned by Division Director.

Chief of Accounting 1990 - 1995; Responsible for the direct supervision of 9 employees within the accounting section; areas of responsibility included providing expert witness testimony on a variety of revenue requirement topics; hired and provided hands-on training for new employees; coordinated and managed consulting contracts on major staff projects such as merger requests and rate increase proposals;

Managing Regulatory Auditor, Senior Auditor, Regulatory Auditor 1984 - 1990; Performed audits and analysis as directed; provided expert witness testimony on numerous occasions before the KCC; trained and directed less experienced auditors on-site during regulatory reviews.

Amoco Production Company 1982 - 1984

Accountant Responsible for revenue reporting and royalty payments for natural gas liquids at several large processing plants.

Education

- B.S.B.A. (Accounting) Central Missouri State University
- Passed CPA exam; (Oklahoma certificate # 7562) – Not a license to practice

PUBLIC

ATTACHMENT DD-1
CPAD Operations and Maintenance Expense

Chattanooga Gas Company
Calculation of Attrition Period Operations & Maintenance Expense

Dkt No. 18-00017
CPAD Workpaper
Attachment DD 9

Line No.	Detail	A/ CPAD Test Period FYE 12-31-17	CPAD Adjustments B/ Adjustment 1 - To Remove Incentive Comp.	C/ Adjustment 2 - To Reflect Cash Basis Pension / OPEB	D/ Adjustment 3 - To Remove Lobbying Costs	E/ Adjustment 4 - To Reduce Corp Allocated Costs	CPAD Adjusted Test Period FYE 12-31-17	F/ Adjustment 5 - To Reflect Rate Case Amortization Expense	G/ Adjustment 6 - To Forecast Attrition Period Costs		H/ CPAD Attrition Period FYE 12-31-19
1	Payroll Expense	$ 3,010,584	[redacted]								$ 2,983,448
2	Employee Benefits	758,528									$ 728,437
3	Benefits Capitalized	(97,884)									$ (103,075)
4	Fleet Services and Facilities Expense	787,488									$ 822,931
5	Outside Services	1,783,744									$ 1,878,336
6	Bad Debt Expenses	137,686								I/	$ 121,863
7	Sales Promotion Expense	51,966									$ 52,574
8	Customer Service and Account Expense	4,775									$ 4,831
9	Administrative and General Expenses	676,172									$ 829,853
10	Admin & Gen. Salaries & Exp. Capitalized	(66,180)									$ (69,690)
11	Other Distribution and Storage Expense	567,215									$ 597,294
12	AGL Service Company Allocations	4,457,091									$ 3,117,375
13	Total O&M Expense	$ 12,067,184									$ 10,964,177

A/ CPAD Workpaper, Attachment DD 9-13
B/ CPAD Workpaper, Attachment DD 4-1
C/ CPAD Workpaper, Attachment DD 4-2
D/ CPAD Workpaper, Attachment DD 4-3
E/ CPAD Workpaper, Attachment DD 4-4
F/ CPAD Workpaper, Attachment DD 4-5
G/ CPAD Workpaper, Attachment DD 4-6
H/ CPAD Workpaper, Attachments DD 9-1, 9-2, 9-3, 9-4, 9-5, 9-6, 9-7, 9-8, 9-9, 9-10, and 9-11
I/ CPAD Rate Base Workpaper RB-46-2.00.

Chattanooga Gas Company
Calculation of Test Period Operations and Maintenance Expenses

Dkt No. 18-00017
CPAD Workpaper
Attachment DD 9-13

Expense Classification	Company Test Period FYE 6-31-17	CPAD Test Period FYE 12-31-17	
Payroll Expense	$ 3,028,489	$ 3,010,584	A/
Employee Benefits	933,858	758,528	B/
Benefits Capitalized	(72,402)	(97,884)	C/
Fleet Services and Facilities Expense	803,695	781,488	D/
Outside Services	1,823,532	1,783,744	E/
Bad Debt Expense	129,715	137,686	F/
Sales Promotion Expense	34,077	51,966	G/
Customer Service and Account Expense	8,533	4,775	H/
Administrative and General Expenses	663,355	678,172	I/
Admin & Gen. Salaries & Exp. Capitalized	(73,550)	(66,180)	J/
Other Distribution and Storage Expense	735,624	567,215	K/
AGL Service Company Allocations	4,106,553	4,457,090	L/
Total O&M	**$ 12,121,478**	**$ 12,067,184**	

A/ CPAD Workpaper, Attachment DD 09-13.01
B/ CPAD Workpaper, Attachment DD 09-13.02
C/ CPAD Workpaper, Attachment DD 09-13.03
D/ CPAD Workpaper, Attachment DD 09-13.04
E/ CPAD Workpaper, Attachment DD 09-13.05
F/ CPAD Workpaper, Attachment DD 09-13.06
G/ CPAD Workpaper, Attachment DD 09-13.07
H/ CPAD Workpaper, Attachment DD 09-13.08
I/ CPAD Workpaper, Attachment DD 09-13.09
J/ CPAD Workpaper, Attachment DD 09-13.10
K/ CPAD Workpaper, Attachment DD 09-13.11
L/ CPAD Workpaper, Attachment DD 09-13.12

Chattanooga Gas Company
Adjustment to Remove Incentive Compensation

Dkt No. 18-00017
CPAD Workpaper
Attachment DD 4-1

	Sub Acct	Account Name		
CGC Direct Charged				
	670590	AIP Bonus	[redacted]	A/
	670591	LTI Awards - Other		A/
CGC Allocated				
	670590	AIP Bonus		B/
	670591	LTI Awards - Other		B/
Total Incentive Comp charged to O&M				

A/ CPAD Workpaper, Attachment DD 09-13.01
B/ CPAD Workpaper, Attachment DD 09-13.12

Chattanooga Gas Company
Adjustment to Remove Accrual Pension & OPEB Benefits

Dkt No. 18-00017
CPAD Workpaper
Attachment DD 4-2

CGC Direct Charged	Sub Acct	Account Name	[redacted]	
	670451	Non-Qualified Pension Plan		A/
	670450	Pensions		A/
	670503	Other Post Retirement Benefits		A/
	670512	Pensions-Capitalized		A/
		Cash Basis Pension Contrib.		C/
Allocated SERP				
	670451	Non-Qualified Pension Plan		B/
	670450	Pensions		B/
	670503	Other Post Retirement Benefits		B/
	670512	Pensions-Capitalized		B/
Total Adjustment				

A/ CPAD Workpaper, Attachment DD 09-13.02
B/ CPAD Workpaper, Attachment DD 09-13.12
C/ CPAD Discovery Request 1-308

Chattanooga Gas Company
Adjustment to Remove Lobbying/Govt Affairs Charges

Dkt No. 18-00017
CPAD Workpaper
Attachment DD 4-3

CGC Allocated

Ferc	Sub Acct	Account Name		
920	600120	Pay - A and G Salaries	[redacted]	A/
920	600201	Pay-Telecommuting	[redacted]	A/
926	670505	Flex Vacation Deductions	[redacted]	A/
926	670525	Miscellaneous Benefits	[redacted]	A/
920	670594	Other/Sales Bonusus	[redacted]	A/
926	670596	Prevenetive Care Incentives	[redacted]	A/
		Subtotal Lobbying/Governmental Affairs Charges	[redacted]	
		Fixed Compensation Benefit Rate	[redacted]	
		Benefit Costs	[redacted]	

CGC Allocated

Ferc	Sub Acct	Account Name		
923	672556	Allocated Legal Lobbying - SCS	[redacted]	B/
		Subtotal	[redacted]	
		Fixed Compensation Benefit Rate	[redacted]	
		Benefit Costs	[redacted]	
		Total Labor Costs	[redacted]	
		Total Benefit Costs	[redacted]	

CGC Allocated

Ferc	Sub Acct	Account Name		
930	670800	Lobbying Portion of Organization Dues	[redacted]	C/
		Lobbying Labor	[redacted]	
		Benefit Costs	[redacted]	
		Organization Dues	[redacted]	
		Grand Total Lobbying	[redacted]	

A/ CPAD Discovery Request 1-141 (CONFIDENTIAL)
B/ CPAD Discovery Request 1-119
C/ CPAD Discovery Request 1-154

Chattanooga Gas Company
Adjustment of Corporate Costs Allocation

Dkt No. 18-00017
CPAD Workpaper
Attachment DD 4-4

Detail	A/ CGC Allocation 2017	B/ CPAD Pro-Forma 2017
1Q	[redacted]	[redacted]
2Q		
3Q		
4Q		
Average		
Composite Rate Charges		
Comp. Rate Charges/ Avg		
Com Rate Charges/Avg * CPAD 3 factor avg		
CPAD Allocation Adjustment (line 13-line 9)		

A/ CONFIDENTIAL Discovery Request CPAD-1-347h, CPAD-1-347i, CPAD-1-347j, CPAD-1-347k
B/ CPAD Workpaper, Attachment DD 4-4.1
C/ CPAD-1-347c 2017

Month		Amortization	Deferred Balance
September, 2018		[redacted]	A/
October			
November			
December			
January, 2019			
February			
March			
April			
May			
June	Midpoint		
July			
August			
September			
October			
November			
December			
	Attrition Year Amortization Expense		

A/ CPAD Rate Base Workpaper RB-45-2.00.

Chattanooga Gas Company
Calculation of Attrition Period CGC Operations and Maintenance Expense

Dkt No. 18-00017
CPAD Workpaper
Attachment DD 4-6

Detail	A/ CPAD Adjusted Test Period FYE 12-31-17	B/ Attrition Period Costs		CPAD Attrition Period FYE 12-31-19
Payroll Expense	[redacted]	[redacted]		$ 2,983,448
Employee Benefits				728,437
Benefits Capitalized				(103,075)
Fleet Services and Facilities Expense				822,931
Outside Services				1,878,336
Bad Debt Expenses			C/	121,863
Sales Promotion Expense				52,574
Customer Service and Account Expense				4,831
Administrative and General Expenses			D/	829,853
Admin & Gen. Salaries & Exp. Capitalized				(69,690)
Other Distribution and Storage Expense				597,294
AGL Service Company Allocations				3,117,375
Total O&M Expense				$ 10,964,177

A/ CPAD Workpaper, Attachment DD 9
B/ CPAD Workpaper, Attachments DD 9-1, 9-2, 9-3, 9-4, 9-5, 9-6, 9-7, 9-8, 9-9, 9-10, and 9-11
C/ CPAD Rate Base Workpaper RB-46-2.00.
D/ Includes CPAD Adjustment 5 to reflect amortization of rate case expense

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

November 8, 2010

IN RE:	)	
	)	
PETITION OF CHATTANOOGA GAS COMPANY	)	
FOR A GENERAL RATE INCREASE,	)	DOCKET NO.
IMPLEMENTATION OF THE ENERGYSMART	)	09-00183
CONSERVATION PROGRAMS AND	)	
IMPLEMENTATION OF A REVENUE	)	
DECOUPLING MECHANISM	)	

ORDER

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This matter came before Chairman Sara Kyle, Director Eddie Roberson, and Director Mary W. Freeman, of the Tennessee Regulatory Authority ("Authority" or "TRA"), the voting panel assigned to this docket, at a regularly scheduled Authority Conference held on May 24, 2010 for consideration of the *Petition of Chattanooga Gas Company for a General Rate Increase, Implementation of the Energy SMART Conservation Programs and Implementation of a Revenue Decoupling Mechanism* ("*Petition*") filed on November 16, 2009. In the *Petition*, Chattanooga Gas Company ("CGC" or "the Company") seeks Authority approval to increase gas utility rates, implement an energy conservation program, and implement a revenue decoupling mechanism.

Upon consideration of the entire record, including all exhibits and the testimony of witnesses, the panel unanimously voted that the Company had a Revenue Deficiency of $60,068, which should be recovered from base rates and from the single rate per thermo of usage for the residential customer class. These conclusions, as well as other decisions, are fully discussed below.

TRAVEL OF THE CASE

CGC filed its *Petition*, Minimum Filing Guidelines, a revised Tariff and the pre-filed testimony of CGC's witnesses: Daniel P. Yardley, Marcie H. Shields, Steven L. Lindsey, Donna Peeples, Daniel J. Nikolich, Ronald D. Hanson, Rhonda Watts, Archie Hickerson, and Dr. Roger A. Morin on November 16, 2009. CGC requested recovery of approximately $2.6 million of revenue deficiency, proposed implementation of an energy conservation program called EnergySMART, and adoption of an Alignment and Usage Adjustment ("AUA") revenue decoupling mechanism. On the same date, the Company also filed a *Proposed Procedural Schedule* and a *Proposed Agreed Protective Order*. At a regularly scheduled Authority Conference held on November 30, 2009, the Authority unanimously voted to convene a

contested case proceeding, suspend CGC's tariff for ninety days, and appoint General Counsel or his designee as Hearing Officer for the purpose of preparing the case for Hearing.[1]

The Consumer Advocate and Protection Division of the Office of the Attorney General ("Consumer Advocate") filed a *Petition to Intervene* on December 8, 2009. The Chattanooga Manufacturers Association ("CMA") filed a *Petition to Intervene* on December 11, 2009. The Hearing Officer granted the petitions to intervene and issued an *Order Granting Petitions to Intervene and Establishing a Procedural Schedule* on December 23, 2009.

On December 28, 2009, the Consumer Advocate filed a *Proposed Protective Order* and on the same day the Hearing Officer filed a *Notice of Public Comment* seeking comment on the competing proposed protective orders filed in the docket. The Hearing Officer noted that for several years a "model" protective order has been used by the TRA, however, CGC and the Consumer Advocate submitted separate proposed protective orders containing different language. The Consumer Advocate argued that the CGC's protective order gave too much discretion to the Company in designating documents as confidential and submitted its protective order for use in this docket, as well as other dockets, on a going forward basis. Because there has been an ongoing disagreement about certain language in the protective order used in various dockets, the TRA invited public comment on the opposing versions of the protective orders to be considered by the TRA in another docket.

On December 29, 2010, CMA petitioned to have CGC's request for reimbursement of legal fees in Docket No. 07-00224[2] included in this docket. CMA claimed that the request for $700,000 in legal fees should be included in the rate case because (1) the request is for a specific

---

[1] *See Order Convening a Contested Case, Suspending Tariff for Ninety Days and Appointing a Hearing Officer* (January 13, 2010).

[2] Motion Of Chattanooga Manufacturers Association To Combine The Request Of CGC For Reimbursement Of Increase In Docket 09-00183, Docket No. 09-00183 (December 29, 2009); *See also* CGC's Motion to Accumulate and Defer Litigation Costs filed in *In re: Docket to Evaluate Chattanooga Gas Company's Purchases and Related Sharing Incentives*, Docket No. 07-00224 (February 28, 2008).Legal Fees In Docket 07-00224 With The Request Of CGC For A General Rate

expense, (2) CGC's ratepayers need to have public notice of this increase, as well as, the opportunity to comment, and (3) the TRA does not have the statutory authority to award legal fees outside of a rate case proceeding. On January 8, 2010, the Consumer Advocate and CGC filed a response to CMA's request. The Consumer Advocate agreed with CMA, stating that the TRA does not have the statutory authority to award legal fees. The Consumer Advocate argued further that regardless of the docket in which the legal expenses are presented, they are simply litigation costs unrelated to the instant rate case, and therefore, the legal fees cannot be considered a just and reasonable cost of providing service and cannot be awarded under any circumstances. CGC argued that the legal fees should be categorized as "gas-related costs" and collected from ratepayers under the Purchased Gas Adjustment ("PGA") rules of the TRA that allows for amounts paid to a consultant by a local distribution company to be recorded in the Deferred Gas Cost Account and recovered through a PGA filing.[3] The Hearing Officer granted CMA's motion to combine and issued an *Initial Order Granting the Motion to Combine* on February 11, 2010, finding that the legal fees requested in Docket No. 07-00224 were not "gas-related costs" and could not be collected pursuant to the PGA rules. Further, the Hearing Officer found that legal fees and regulatory expenses are regularly evaluated in the context of a rate case, and if considered valid and prudent, they are included in a portion of the overall cost of service for recovery through base rates.

On February 17, 2010, the parties submitted a *Proposed Agreed Protective Order.*[4] The Hearing Officer issued the *Agreed Protective Order* on February 19, 2010. The parties completed discovery in the form of interrogatories and requests for production of documents and the intervening parties submitted their pre-filed direct testimony on March 10, 2010. The

[3] Tenn. Comp. R. & Reg. 1220-4-7-.05(1)(a)(3).

[4] In the cover letter to the *Proposed Agreed Protective Order*, CGC's counsel stated that the parties had reached an agreement to use this protective order solely in Docket No. 09-00183 and by using this protective order, it would not create any precedent regarding use in future dockets. At the April 26, 2010 Authority Conference, the Directors voted 2-1 to open a generic docket to examine proposed modifications to the Authority's model protective order.

Consumer Advocate filed the direct testimony of John Hughes, Dave Peters, Dr. Christopher C. Klein, Dr. David E. Dismukes, and Terry Buckner. CMA filed the direct testimony of Phillip E. Pickett.[5] On April 5, 2010, CGC filed the rebuttal testimony of Daniel P. Yardley, Archie R. Hickerson, Steve Lindsey, Dr. Roger A. Morin, Daniel J. Nikolich, Marcie H. Shields, Rhonda Watts, Donna Peeples, and Ronald D. Hanson.

CGC filed a *Motion in Limine* on April 5, 2010. CGC sought to strike portions of pre-filed testimony and pre-filed supplemental testimony filed by Terry Buckner of the Consumer Advocate concerning a CGC affiliate, South Star. Specifically, CGC stated it had previously objected to discovery of information concerning South Star during the discovery phase of the proceeding and further objected to the relevance of testimony with respect to South Star and to its admissibility as part of the record during the Hearing on the merits. CGC argued that these matters were litigated in Docket No. 07-00224 and the Consumer Advocate had the opportunity in that docket to review matters related to asset management practices and dealings with CGC's gas and capacity supply assets. Therefore, CGC stated that such Purchase Gas Adjustment ("PGA") matters are not part of this rate case and portions of testimony related to these issues and any of South Star's secondary transactions should be stricken and not admitted into the record during the Hearing on the merits. On April 7, 2010, the Consumer Advocate responded to CGC's *Motion in Limine* and stated that the transactions involving South Star are not related to Docket No. 07-00224 and the South Star issue involves affiliate transactions, not the asset management agreement between Sequent and CGC. The Hearing Officer heard oral argument from the parties on this issue during a Pre-Hearing Conference held on April 6, 2010. On April 9, 2010, the Hearing Officer issued *Order Addressing Several Pretrial Motions* wherein the Hearing Officer granted CGC's *Motion In Limine* and ruled that the South Star issue is not

[5] On March 26, 2010, the CMA filed a notice stating that its expert witness, Edward Colucci would be replacing Phillip E. Pickett as CMA's expert witness.

relevant in this docket.

On April 8, 2010, the Consumer Advocate filed its *Stipulation of the Consumer Advocate* ("Stipulation") with regard to the rate base of CGC for the twelve month period ending April 30, 2011. The Consumer Advocate stated that CGC's witness Ronald D. Hanson's recalculation of CGC's rate base resulted in an immaterial variance between the Consumer Advocate's position and CGC's resulting rate base. Therefore, the Consumer Advocate agreed to stipulate to CGC's resulting rate base; however, it did not stipulate to the individual calculations in determining the rate base. Additionally, the Consumer Advocate stated that it was in agreement with CGC on the following Statement of Income items: Base Revenues, Other Revenues, Interest on Customer Deposits and Taxes Other than Federal Income and State Excise and agreed not to present live testimony as to these stipulated items. However, the Consumer Advocate reserved its right to assert its position as articulated in its pre-filed testimony, in future proceedings or in this rate case in the event CGC attempted to cross-examine any Consumer Advocate witness on rate base issues during the Hearing on the merits.

II. THE HEARING AND POST HEARING FILINGS

On March 19, 2010, the Hearing Officer issued a *Notice of Public Service Standard Hearing and Pre-Hearing Conference*, setting a Public Service Standard Hearing and Pre-Hearing Conference to be held on April 6, 2010 in Chattanooga, Tennessee. On the same day, the Hearing Officer issued a *Notice of Hearing* setting the Hearing on the merits before the panel in Nashville, Tennessee, beginning on April 12, 2010 through April 13, 2010 and to reconvene on April 26, 2010.

In advance of the Public Service Standard Hearing in Chattanooga on April 6, 2010, the Hearing Officer held a Pre-Hearing Conference during which he addressed several outstanding discovery issues, the Consumer Advocate's *Motion to Compel* regarding the attorney billings

related to Docket No. 07-00224 and CGC's *Motion in Limine* to strike portions of the testimony of Consumer Advocate witness, Terry Buckner. The Hearing Officer denied the Consumer Advocate's *Motion to Compel*, stating that the Consumer Advocate has recourse to pursue the SouthStar issue during the next triennial review as established in Docket No. 07-00224. As to the issue of production of the unredacted version of CGC's attorney fee billing statements, the Hearing Officer ruled that he would conduct an in camera review of the documents to determine whether those statements would be produced. Further, the Hearing Officer ruled on the attorney-client privilege issue as to the attorney fee billings submitted by CGC and removed the confidentiality designation from the redacted legal billing statements submitted by CGC in support of its litigation expenses thereby making those statements public documents. Finally, the Hearing Officer granted CGC's *Motion in Limine* to strike the testimony of Terry Buckner as to the issue related to SouthStar.

After the Pre-Hearing Conference, the TRA heard public comment during the Public Service Standard Hearing held in Chattanooga. Customers of Chattanooga Gas Company provided statements regarding their experiences with CGC and the rates proposed by the Company. Additionally, written comments were filed by members of the public. On April 9, 2010, the Company filed copies of the legal notices regarding the proposed rate change and the Hearing date that were published in appropriate newspapers of general circulation, as required by TRA Rule 1220-4-1-.05. During the Hearing in Nashville, Tennessee, the panel again solicited comments from the public, but no one sought to be heard.

The Hearing on the merits of the Petition commenced in Nashville and was held on April 12, 2010, April 13, 2010, and April 26, 2010. Participating in the Hearing were the following parties and their respective counsel:

Chattanooga Gas Company – J.W. Luna, Esq. and Jennifer Brundidge, Esq., Farmer & Luna, 333 Union Street, Suite 300, Nashville, Tennessee 37201; **Elizabeth**

Wade, Esq., AGL Resources Inc., Ten Peachtree Place, N.W., 15th Floor, Atlanta, GA 30309; **Kenneth T. Maloney, Esq.,** Cullen and Dykman, LLP, 1101 14th Street, NW, Suite 550, Washington, D.C. 20005-5633; and **Archie Hickerson**, AGL Resources, Inc., 150 W. Main Street, Suite 1510, Norfolk, Virginia 23510.

Consumer Advocate – Ryan McGehee, Esq., C. Scott Jackson, Esq., T.J. Warner, Esq., Vance Broemel, Esq., and Cynthia Kinser, Esq., Consumer Advocate and Protection Division of the Office of the Attorney General, P.O. Box 20207, Nashville, Tennessee 37202.

Chattanooga Manufacturers Association – Henry Walker, Esq., Boult, Cummings, Conners & Berry, PLC, 1600 Division Street, Suite 700, Nashville, Tennessee 37203; and **Ray Childers**, CMA President, 10 W. Martin Luther King Blvd., Chattanooga, Tennessee 37403.

The panel heard testimony from Company witnesses: Steven L. Lindsey, Donna Peeples, Daniel J. Nikolich, Ronald D. Hanson, Rhonda Watts, Daniel P. Yardley, Archie Hickerson, and Dr. Roger A. Morin. Witnesses presented by the Consumer Advocate were: Dr. David Dismukes, Terry Buckner, John Hughes, and Dr. Christopher Klein.

The Company revised its forecast during the course of the proceeding, resulting in a final projected revenue deficiency of $2.2 million. The Consumer Advocate also submitted a revised forecast, resulting in a final projected revenue surplus of $0.3 million, with the exclusion CGC's decoupling mechanism, or a $0.7 million revenue surplus if the Authority approved some type of decoupling mechanism.

Prior to the conclusion of the Hearing on April 26, 2010, the parties agreed to submit Post-Hearing Briefs to the TRA. On May 7, 2010, the Consumer Advocate filed its *Stipulation*

of the Consumer Advocate, Joint Submission of Agreed Late Filed Exhibits and the *Consumer Advocate and Protection Division's Post-Hearing Brief.* On the same day, the CMA filed *Chattanooga Manufacturer's Post-Hearing Brief* and the Company filed *Chattanooga Gas Company's Post-Hearing Brief.*

III. CRITERIA FOR ESTABLISHING JUST AND REASONABLE RATES

In setting rates for public utilities, the Authority is required to balance the interests of the utilities subject to its jurisdiction with the interests of Tennessee consumers, i.e., it is obligated to fix just and reasonable rates.[6] The Authority must approve rates that provide regulated utilities the opportunity to earn a just and reasonable return on their investments[7] while avoiding the exploitation of consumers by not setting exorbitant rates. "A rate need only fall within the 'zone of reasonableness' . . . that takes into consideration the interests of both the consumer and the utility."[8]

The Authority considers a petition for a rate increase, filed pursuant to Tenn. Code Ann. § 65-5-203, in light of the following criteria:

1. The investment or rate base upon which the utility should be permitted to earn a fair rate of return;

2. The proper level of revenues for the utility;

3. The proper level of expenses for the utility; and

4. The rate of return the utility should earn.

The general standards to be considered in establishing the costs of common equity for a public utility are financial integrity, capital attraction and setting a return on equity ("ROE") that is commensurate with returns investors could achieve by investing in other enterprises of

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[6] Tenn. Code Ann. § 65-5-201 (Supp. 2004).

[7] *See Bluefield Water Works and Improvement Company v. Public Service Commission of the State of West Virginia*, 262 U.S. 679, 43 S.Ct. 675 (1923).

[8] *Tennessee Cable Television Ass'n. v. Tennessee Pub. Serv. Comm'n*, 844 S.W.2d 151, 159 (Tenn. Ct. App. 1992).

corresponding risk. The utility's cost of common equity is the minimum return investors expect, or require, in order to make an investment in the utility.[9]

In determining a fair rate of return, the Authority must conduct an in-depth analysis and give proper consideration to numerous factors, such as capital structure, cost of capital and changes which can reasonably be anticipated in the foreseeable future. The Authority has the obligation to make this determination based upon the controlling legal standard set forth in the landmark cases of *Bluefield Water Works and Improvement Company v. Public Service Commission of the State of West Virginia*[10] and *Federal Power Commission v. Hope Natural Gas Company,*[11] which have been specifically relied upon by the Tennessee Supreme Court.[12]

In the *Bluefield* case, the United States Supreme Court stated:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risk and uncertainties; but it has no constitutional rights to profits such as are realized or anticipated in highly profitable or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economical management to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.[13]

Later, in the *Hope* case, the United States Supreme Court refined these guidelines, holding that:

> From the investor or company points of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise so as to maintain its credit and to attract capital.[14]

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[9] *See Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 64 S.Ct. 281 (1944).
[10] *Bluefield Water Works and Improvement Company v. Public Service Commission of the State of West Virginia*, 262 U.S. 679, 43 S.Ct. 675 (1923).
[11] *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 64 S.Ct. 281 (1944).
[12] *Southern Bell Telephone & Telegraph Co. v. Public Service Commission*, 304 S.W.2d 640, 647 (1957).
[13] *Bluefield*, 262 U.S. at 692-93.
[14] *Hope,* 320 U.S. at 603.

Thus, rates established must allow a company to cover its operating expenses and provide an opportunity to earn a fair rate of return on a company's investment used to provision service. Further, a rate should be reasonable not only when it is first established but also for a reasonable time thereafter.[15] When the TRA considers whether a rate is just and reasonable, it "should take into consideration the known and/or estimated effect of reasonably expected expenses and investments."[16]

Applying these principles, and upon consideration of the entire record, including all exhibits and the testimony of the witnesses, the panel made the following findings and conclusions.

IV. TEST PERIOD AND ATTRITION PERIOD

In a rate case, the Authority must decide which test period is appropriate. The goal of selecting the test period is to provide an indication of the rate of return that will be produced during the period under the existing rate structure in the reasonably foreseeable future. The test period takes into consideration the estimated effect of calculations related to revenues, expenses and investments.

The Company used the twelve months ended June 30, 2009 as its test period, while the Consumer Advocate used the twelve months ended December 31, 2009. The TRA found that the best test period would be the one that will be the best basis for forecasting individual items for the attrition period. While the panel noted that the test period for the most recent period is generally preferred, such as the December 31, 2009 test period used by the Consumer Advocate, circumstances may exist which favor the use of the June 30, 2009 test period used by the

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[15] *McCardle v. Indianapolis Water Co.*, 272 U.S. 400, 408-409, 47 S.Ct. 144, 148 (1926) *Southern Bell Tel. & Tel. Co. v. Tennessee Pub. Serv. Comm'n,*, 202 Tenn. at 482, 304 S.W.2d at 647.

[16] *Tennessee Cable Television Ass'n v. Tennessee Public Service Comm'n*, 844 S.W.2d 151, 159-160 (Tenn. Ct. App. 1992) *citing Southern Bell Tel. Co. v. Tennessee Pub. Serv. Comm'n*, 579 S.W.2d 429, 435 (Tenn. Ct. App. 1979).

Company. The test periods used in this case for rate setting purposes were chosen to provide the Company the opportunity to earn a fair rate of return on its investment.

The TRA panel voted unanimously to adopt the twelve months ending April 30, 2011 for the attrition period since all the parties reached agreement on this attrition period and it represents the period during which the proposed rates would be in effect.

V. CONTESTED ISSUES

The position of the parties and the determinations of the voting panel are set out below for each of the following contested issues: Section V(a) - Revenues, Section V(b) - Expenses, Section V(c) – Taxes Other Than Income, Section V(d) – Income Taxes, Section V(e) – Net Operating Income, Section V(f) – Rate Base, Section V(g) – Revenue Conversion Factor, Section V(h) – Rate of Return, Section V(i) – Revenue Deficiency, Section V(j) Other issues, and Section V(k) Rate Design.

V(a). REVENUES

V(a)1. TOTAL OPERATING MARGIN

Total Operating Margin consists of the sum of Base Revenues, Other Revenues and Allowance for Funds Used During Construction ("AFUDC") less the Cost of Gas. The parties stipulated to the amounts for Base Revenues, Other Revenues, and Cost of Gas. In rebuttal testimony, the Company accepted the Consumer Advocate's forecast of operating revenues and cost of gas as a reasonable update, even though it did not agree with the method used to compute the amount.[17] The panel voted unanimously to adopt the agreed upon revenue amounts as follows:

[17] Ronald D. Hanson, Pre-Filed Rebuttal Testimony, pp. 4-5 (April 6, 2010).

V(a)2. BASE REVENUES

The Base Revenues were determined by the TRA to be $29,028,086 based on the Consumer Advocate's updated billing determinates and current rates.

V(a)3. OTHER REVENUES

The TRA calculated the proper amount for Other Revenues as $686,066.

V(a)4. ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION

The parties did not agree on a proper amount for AFUDC, the final revenue component of Total Operating Margin. AFUDC is a non-cash item that reflects the period cost of capital devoted to plant under construction. Costs associated with current projects are a reduction to rate base. As projects are completed, these costs are transferred to Plant in Service. The Company initially stated a projected AFUDC of $352,221[18] by multiplying the forecasted balance of Construction Work in Progress ("CWIP"), $4,252,910 for the attrition period (non-inclusive of corporate allocated CWIP),[19] by the estimated weighted average cost of capital ("WACC") of 8.28% for the attrition period.[20] The forecasted balance of CWIP is based on the thirteen month average CWIP during the test year.[21] The Consumer Advocate took the amount of plant additions in the attrition period from May 2010 to April 2011,[22] and multiplied the individual monthly plant additions by its forecast of the weighted average cost of capital of 7.29%[23] to arrive at a monthly AFUDC. The individual monthly AFUDC was then totaled for an attrition period AFUDC amount of $210,826.

In Rebuttal Testimony, the Company agreed with the process used by the Consumer Advocate in forecasting AFUDC for the attrition period, but disagreed with the cost of capital

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[18] Ronald D. Hanson, Pre-Filed Direct Testimony, Exhibit RDH-1, Schedule 1 (November 16, 2009).
[19] Revised Consumer Advocate Exhibits, Schedule 8 (April 16, 2010).
[20] Ronald D. Hanson, Pre-Filed Direct Testimony, Exhibit RDH-1, Schedule 1 (November 16, 2009).
[21] Ronald D. Hanson, Pre-Filed Direct Testimony, p. 7 (November 16, 2009).
[22] Terry Buckner, Pre-Filed Direct Testimony, Workpaper RAFUDC, p. 2 (March 10, 2010).
[23] TRA FG Item No. 43, CGC Attachment 43-1 (November 16, 2009).

applied to determine AFUDC. Using its percentage of 8.28%, rather than the Consumer Advocate's cost of capital, the Company revised its forecast of AFUDC for the attrition period to the amount of $239,457.[24]

While the panel accepted the parties' agreed upon process using the amount of plant additions from May 2010 to April 2011, the panel rejected both parties' calculations for AFUDC because the panel adopted a different cost of capital as discussed in detail below. The panel applied its determined weighted average cost of capital of 7.419% to the plant additions from May 2010 to April 2011 and adopted $214,551 as the proper forecast amount for AFUDC during the attrition period.

Thereafter, the panel voted unanimously to adopt a Total Operating Margin of $29,928,703. The panel arrived at $29,928,703 based on the sum of the amounts it had adopted for Base Revenues in the amount of $29,028,086, Other Revenues in the amount of $686,066, and AFUDC in the amount of $214,551.

V(b). EXPENSES

V(b)1. TOTAL OPERATING EXPENSE

Total Operating Expense consists of the sum of: Operation and Maintenance Expense; Interest on Customer Deposits; Depreciation Expense; Taxes Other than Income Tax; and State Excise and Income Taxes. The Company projected Total Operating Expense of $23,546,051 for the attrition period. The Consumer Advocate forecasted the Total Operating Expense of $22,897,185 for the attrition period.[25] The panel unanimously voted to adopt Total Operating Expense of $23,004,863 for the attrition period of based upon each expense component discussed below.

[24] Ronald D. Hanson, Pre-Filed Rebuttal Testimony, p. 5 (April 6, 2010).
[25] Revised Consumer Advocate Exhibits, Schedule 3 (April 16, 2010).

V(b)2. PAYROLL EXPENSE

The payroll expense is the direct labor expenses of the Company's employees in Chattanooga. The Company originally forecasted a Tennessee direct attrition period Payroll Expense of $2,147,475.[26] This forecast is based on identified forty full-time Tennessee direct employees during the attrition period.[27] To price out attrition period Payroll Expense, the Company started with the actual annualized base pay at June 21, 2009, the final payroll in the test year. Base pay at June 30, 2009 was adjusted for known and expected changes. The portion of employees' time spent working on capital projects was not considered payroll expense. A capitalization rate was calculated, so that a portion of payroll is included in the cost of capital projects. In this case, total forecasted base pay plus non-base pay was capitalized using the Company's capitalization rate of 7.98%.[28]

The Consumer Advocate forecasted Tennessee direct attrition period Payroll Expense of $2,198,645.[29] The Consumer Advocate used its test period of twelve months ended December 31, 2009.[30] The forecast is based on thirty-nine full-time employees during the attrition period. The Consumer Advocate priced out the attrition period Payroll Expense beginning with the actual annualized base pay at December 31, 2009 for the test year total. The forecast includes 3% merit increases for March, 2010 and March, 2011 to arrive at the attrition year amount. The Consumer Advocate forecasted premium payroll which included overtime, double time, and beeper pay for non-base pay for hourly and Liquefied Natural Gas ("LNG") hourly employees using the total premium pay on December 31, 2009. The total forecasted salaried and hourly employees' payroll amount of $2,378,711 was reduced by the capitalized amount of $180,066

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[26] Ronald D. Hanson, Pre-Filed Direct Testimony, Exhibit RDH-2, Schedule 2 (November 16, 2009).
[27] Ronald D. Hanson, Pre-Filed Direct Testimony, p. 8 (November 16, 2009).
[28] Capitalization percentage based upon test period capitalization rate. The capitalization for the twelve months ended June 30, 2008 of 6.75% is also presented for comparability in the Company response to TRA FG Item No. 45, Schedule 45–1 (Page 1 of 2).
[29] John Hughes, Pre-filed Direct Testimony, p. 8 (March 10, 2010).
[30] John Hughes, Pre-filed Direct Testimony, p. 8 (March 10, 2010).

using the capitalization rate 7.57%,[31] resulting in a total direct Payroll Expense for the attrition period of $2,198,645.[32] The attrition period forecast was $51,170 higher than the Company's original calculation. In Rebuttal Testimony, the Company adopted the Consumer Advocate's price out amount of $2,198,645.[33]

After reviewing the record and the parties' calculations, the panel found that the price out method used to forecast the attrition year payroll expense is reasonable, based on actual employee count at December 31, 2009, applying known rates for premium payroll and salaried payroll. Further, the panel found that the capitalization rate of 7.57% was reasonable and voted unanimously to adopt the attrition period payroll expense of $2,198,645, as agreed to by the parties.

V(b)3. EMPLOYEE BENEFITS

The Company projected Employee Benefits Expense of $1,129,340 for the attrition period. The Consumer Advocate forecasted $1,061,662 for Employee Benefits Expense.[34] The difference of $67,679 is for Annual Incentive Plan ("AIP") Bonus Expense. The AIP bonus is based on employee performance criteria which address safety, customer service, operating efficiency, and compliance.[35] CGC included $135,358 in compensation for employees for the AIP bonuses during the attrition year. The Consumer Advocate proposed to allow 50% of the Company's AIP bonus expense because the current AIP plan serves the interests of both ratepayers and stockholders.

The panel found that the AIP bonuses are designed to improve the performance of employees and thus provides a benefit to both the ratepayers and stockholders. Ultimately, this

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[31] John Hughes, Pre-Filed Direct Testimony, Consumer Advocate Work Paper E-SUMMARY (March 10, 2010).
[32] John Hughes, Pre-Filed Direct Testimony, Consumer Advocate Work Paper E-PAY SUMMARY (March 10, 2010).
[33] Ronald D. Hanson, Pre-Filed Rebuttal Testimony, Exhibit RDH-5, Schedule 5 (April 6, 2010).
[34] Revised Consumer Advocate Exhibits, Schedule 4 (April 16, 2010).
[35] Testimony of John Hughes, Transcript of Hearing, pp. 632-633, lines 20-22 (April 13, 2010).

will result in more efficient operation of the Company. Therefore, the Authority determined that it was reasonable for each group to bear the cost of the plan and pay 50% of the cost of the plan. The panel voted unanimously to adopt an attrition period forecast of $1,061,662 for Employee Benefits Expense.

V(b)4. BENEFITS CAPITALIZED

The Capitalized Benefits Expense is forecasted by multiplying the estimated level of benefits expense for the attrition period by the percentage of capitalized payroll to total payroll for the test year. The capitalized benefit is a reduction to the Operation and Maintenance (O&M) expense. The Company projected a level of $(101,369)[36] in Benefits Capitalized for the attrition period. The Consumer Advocate forecasted $(92,776)[37] for Benefits Capitalized expense for the attrition period. The Consumer Advocate's forecast was based upon the Company's booked amount of $1,225,574 for the twelve months ended December 31, 2009 multiplied by the 7.57%[38] capitalization percentage. In its calculation, the Consumer Advocate only includes 50% of AIP bonus expense in the Company's booked amount.

In Rebuttal Testimony, the Company accepted the Consumer Advocate's forecasted amount of $(92,776), but increased $10,588 from the Consumer Advocate's forecasted amount due to updated information regarding Pension contribution and Post Retirement Benefits Expense Other than Pensions ("PBOP") expense. Also, the Company reduced $5,123 from the Consumer Advocate's forecasted amount to add back 50% of the AIP bonus expense to the Company's booked amount. Therefore, the Company's revised projection of Benefits Capitalized expense was $(87,311)[39] for the attrition period. While the Consumer Advocate

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[36] Ronald D. Hanson, Pre-Filed Direct Testimony, Exhibit RDH-2, Schedule 2 (November 16, 2009).
[37] John Hughes, Pre-Filed Direct Testimony, Consumer Advocate Work Paper E-BENEFITS-CAP (March 10, 2010).
[38] John Hughes, Pre-Filed Direct Testimony, Consumer Advocate Work Paper E-PAY SUMMARY (March 10, 2010).
[39] Ronald D. Hanson, Pre-Filed Rebuttal Testimony, Exhibit RDH-5, Schedule 5 (April 6, 2010).

updated its schedules post-Hearing to include the Company's updated pension adjustment, it did not accept adding back 50% of AIP expense to the Company's booked amount.[40] The panel agreed with the Consumer Advocate's calculations, consistent with the treatment of AIP expense in Employee Benefits expense, and voted unanimously to adopt the attrition period forecast of $(82,188) for the Benefits Capitalized expense.

V(b)5. FLEET SERVICES AND FACILITIES EXPENSE

The Company forecasted $861,624 for Fleet Services and Facilities Expense. This is based upon the historical test period amount of $844,524 increased by the Company's inflation factor of 1.0202.[41] The Consumer Advocate forecasted $833,649 for Fleet Services and Facilities Expense based upon the Company booked amount of $816,236 for the twelve months ended December 31, 2009, increased by the Consumer Advocate inflation/growth factor of 1.0213.[42] The Company has accepted the Consumer Advocate's attrition period forecast for Fleet Services and Facilities Expense of $833,649.[43] The panel found that the Consumer Advocate's projection is based upon a more recent test year amount and was properly grown for inflation. Thereafter, the panel voted unanimously to adopt the parties' agreed upon Fleet Services and Facilities Expense amount of $833,649.

V(b)6. OUTSIDE SERVICES EXPENSE

The Company projected Outside Services Expense of $1,442,709 for the attrition period. The Consumer Advocate forecasted $1,046,501 for Outside Services Expense.[44] The difference of $396,208 is for Outside Services – Legal Bills. The Company forecasted $590,821 for Outside Services – Legal Bills. This is based upon the $578,479 of actual booked expenses for

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[40] Updated Exhibits Requested By The TRA At The Conclusion Of Terry Buckner's Testimony On April 13, 2010 (April 16, 2010).
[41] Ronald D. Hanson, Pre-Filed Direct Testimony, Exhibit RDH-2, Schedule 2 (November 16, 2009). Variance due to rounding.
[42] John Hughes, Pre-Filed Direct Testimony, Consumer Advocate Work Paper E-FLEET (March 10, 2010).
[43] Ronald D. Hanson, Pre-Filed Rebuttal Testimony, Exhibit RDH-5, Schedule 5 (April 6, 2010).
[44] Revised Consumer Advocate Exhibits, Schedule 4 (April 16, 2010).

the twelve months ended December 31, 2009 increased by the Consumer Advocate inflation factor of 1.0213. The Consumer Advocate proposed an amount of $194,613 for Outside Services – Legal Bills. This amount is a three year average (2005-2007) of legal bills prior to the initiation of TRA Docket No. 07-00224.

The panel determined that it would not be just and reasonable to include the $744,744 in legal bills for TRA Docket No. 07-00224 in calculating the Outside Services Expense because of the atypical nature of that docket. Instead, the panel found it reasonable to calculate the Outside Services – Legal Bills based upon a three year average of those costs for 2007 through 2009, excluding the legal costs related to TRA Docket No. 07-00224, because costs for this period were based on a more typical test year. Employing this methodology, the panel adopted $185,951 in Outside Services – Legal Bills for the attrition period. To this figure, the panel added the Consumer Advocate's Outside Services expense of $851,888 excluding its forecast of Outside Services – Legal Bills. Thereafter, the panel voted unanimously to adopt $1,037,839 as the Outside Services Expense for the attrition period.

V(b)7. BAD DEBT EXPENSE

The Company developed its uncollectible percentage of .7098793% based on the net charge-offs for the 24 months of 2008 and 2009. The net charge offs for the two year period were summed and then divided by the net margin excluding damaged billing.[45] The Company methodology results in an attrition period expense of $229,587.[46] The Company notes in its testimony that this method was approved by the TRA in CGC's last two rate cases.[47] The Consumer Advocate filed revised exhibits on April 16, 2010 indicating that it accepted the

[45] "Damaged billing" refers to the bills that CGC sends for the cost to repair to its damaged pipes.
[46] Ronald D. Hanson, Pre-filed Rebuttal Testimony, Workpaper 10 (April 6, 2010).
[47] CGC's last two rates cases before the TRA were Docket Nos. 04-00034 and 06-00175. Ronald D. Hanson, Pre-Filed Rebuttal Testimony, p. 8 (April 6, 2010).

Company's methodology (Schedule 4).[48] The panel voted unanimously to adopt the agreed upon bad debt expense of $229,587 because the panel concluded the Company's methodology was reasonable based on historical trends of this expense component.

V(b)8. SALES PROMOTION EXPENSE

The Company projected $23,006 Sales Promotion Expense for the attrition period, based upon the $22,549 of the normalized test year amount increased by the Company inflation factor of 1.0202.[49] The Consumer Advocate forecasted $13,818 for Sales Promotion Expense, based upon the Company's normalized amounts for the twelve months ended December 31, 2009 increased by the Consumer Advocate growth/inflation factor of 1.0213.[50] The Company accepted the Consumer Advocate's attrition period forecast for Sales Promotion Expense of $13,818.[51] The panel found that the Consumer Advocate's projection is based upon a more recent normalized test year amount, properly grown for inflation and adopted the Consumer Advocate's Sales Promotion Expense amount of $13,818, as agreed upon by the Consumer Advocate and the Company.

[48] Revised Consumer Advocate Exhibits, Schedule 4 (April 16, 2010).
[49] TRA FG Item No. 25, CGC Schedule 25-4 (November 16, 2009).
[50] John Hughes, Pre-Filed Direct Testimony, Consumer Advocate Work Paper E-SALES (March 10, 2010).
[51] Ronald D. Hanson, Pre-Filed Rebuttal Testimony, Exhibit RDH-5, Schedule 5 (April 6, 2010).

V(b)9. CUSTOMER SERVICE AND ACCOUNT EXPENSE

The Company forecasted $5,280 for Customer Service and Account Expense for the attrition period. The Company arrived at this figure by applying its inflation factor of 1.0202 to the historical test year amount of $5,176.[52] The Consumer Advocate forecasted $5,930 for Customer Service and Account Expense, based upon the Company booked amount of $5,806 for the twelve months ended December 31, 2009 increased by the Consumer Advocate inflation/growth factor of 1.0213.[53] The Company ultimately accepted the Consumer Advocate's attrition period forecast for Customer Service and Account Expense of $5,930.[54] The panel found that the Consumer Advocate's projection is based upon a more recent test year amount and applies the appropriate inflation factor and was reasonable, and therefore, the panel unanimously adopted the Consumer Advocate's Customer Service and Account Expense amount of $5,930.

V(b)10. ADMINISTRATIVE AND GENERAL EXPENSE

The Administrative and General Expense category includes Legal, Office Administration and Supply, Development and Training, Dues and Subscriptions, Travel and Entertainment, Equipment Leases and Miscellaneous Operation.[55] The Miscellaneous Operation expense contains rate case expense.[56] The Company projected Administrative and General Expense of $1,030,990[57] for the attrition period which included $240,569 of rate case expense. The Company has requested to recover $632,002 in rate case expense from the present docket plus $89,706 for the remaining unrecovered costs from the Docket No. 06-00175 amortized over three years. The Consumer Advocate forecasted $896,957[58] for Administrative and General

[52] Ronald D. Hanson, Pre-Filed Direct Testimony, Exhibit RDH-2, Schedule 2 (November 16, 2009).
[53] John Hughes, Pre-Filed Direct Testimony, Consumer Advocate Work Paper E-CUST. (March 10, 2010).
[54] Ronald D. Hanson, Pre-Filed Rebuttal Testimony, Exhibit RDH-5, Schedule 5 (April 6, 2010).
[55] TRA FG Item No. 25, CGC Schedule 25-1a (November 16, 2009).
[56] TRA FG Item No. 25, CGC Schedule 25-1a (November 16, 2009).
[57] Revised Consumer Advocate Exhibits, Schedule 4 (April 16, 2010).
[58] Revised Consumer Advocate Exhibits, Schedule 4 (April 16, 2010).

Expense which included $106,536[59] of rate case expense. The Consumer Advocate proposed using 50% of the rate case preparation costs of $632,002 amortized over three years and eliminating the unrecovered rate case expense from Docket No. 06-00175.[60] According to the Consumer Advocate, the rate case expense balance from the 2006 rate case should be zero at December 31, 2009.[61]

The panel noted that the only difference between the Company's forecast and the Consumer Advocate's forecast is $134,033 in rate case expense. The Consumer Advocate cites Authority precedent in recommending recovery of only 50% of the legal costs incurred to prepare this case.[62] The Consumer Advocate states that in Docket No. 08-00039, the TRA ruled that it was appropriate for the shareholders to bear some of the expense of the company's rate case expense.[63] However, the TRA also noted in that docket that "in the future the Authority should closely examine the costs associated with rate case filings to determine the portions to be recovered from rate payers and shareholders."[64] In Docket No. 08-00039, the award of 50% of costs was based on the specific facts of that rate case. In the instant docket, the panel closely examined CGC's costs of filing this rate case and found that it was reasonable for CGC to recover the full amount of legal costs because this rate case was filed in compliance with the Settlement Agreement and the TRA's approval of the same in Docket 06-00175.[65] The panel did agree with the Consumer Advocate's position that the 2006 rate case expense should be totally amortized by December 31, 2009. Thus, the panel found it was reasonable to allow the Company to recover the total requested $632,002 for rate case expense in this docket over a three

[59] John Hughes, Pre-Filed Direct Testimony, Consumer Advocate Work Paper E-A&G (March 10, 2010).
[60] Testimony of Ronald D. Hanson, Transcript of Hearing, Volume I, p. 156 (April 12, 2010).
[61] Testimony of Ronald D. Hanson, Transcript of Hearing, Volume I, pp. 151-156 (April 12, 2010).
[62] Consumer Advocate's Post-Hearing Brief, p. 9 (May 7, 2010).
[63] Consumer Advocate's Post-Hearing Brief, p. 9 (May 7, 2010).
[64] *In Re: Petition of Tennessee American Water Company to Change and Increase Certain Rates and Charges So As to Permit it to Earn a Fair and Adequate Rate of Return on Its Property Used and Useful in Furnishing Water Service to Its Customers*, TRA Docket No. 08-000039, Order, p. 24 (January 13, 2009).
[65] As part of the Settlement Agreement that was approved by the TRA in Docket No. 06-00175, the parties agreed that CGC would file another rate case on or before May 28, 2010.

year period, resulting in an annual rate case expense of $210,667. Thereafter, the panel voted unanimously to adopt an attrition period total for administrative and general expense of $1,001,088 after excluding the 2006 rate case expense and calculating the totals allowed for all administrative and general expenses.

V(b)11. Administrative and General Expense Capitalized

The Company projected $(34,456) for Administrative and General Expense Capitalized Expense for the attrition period.[66] The Consumer Advocate's forecast of $(38,668) for Administrative and General Expense Capitalized Expense is based upon the Company booked amount of $(37,860) for the twelve months ended December 31, 2009, increased by the Consumer Advocate's inflation/growth factor of 1.0213.[67] The Company accepted the Consumer Advocate's attrition period forecast for Administrative and General Expense Capitalized Expense of $(38,668).[68] The panel found that the Consumer Advocate's projection is based upon a more recent test year amount and properly grown for inflation. Thereafter, the panel voted unanimously to adopt the agreed upon Administrative and General Expense Capitalized Expense amount of $(38,668).

V(b)12. Other Distribution and Storage Expense

Storage expense represents the costs, other than labor and gas, incurred in operating and maintaining the Company's gas storage assets. The Company owns a LNG facility that is included in the rate base calculation under Plant in Service. The Company projected $574,178 for Other Distribution and Storage Expense for the attrition period. This amount was calculated by applying the Company inflation factor of 2.02% to the test period for Other Distribution and Storage Expense of $495,824.[69] Additionally, the test period expense was increased by $68,314

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[66] Ronald D. Hanson, Pre-Filed Direct Testimony, Exhibit RDH-2, Schedule 2 (November 16, 2009).
[67] John Hughes, Pre-Filed Direct Testimony, Consumer Advocate Work Paper E-A&G-CAP (March 10, 2010).
[68] Ronald D. Hanson, Pre-Filed Rebuttal Testimony, Exhibit RDH-5, Schedule 5 (April 6, 2010).
[69] Ronald D. Hanson, Pre-Filed Direct Testimony, p. 15 (November 16, 2009).

to include the cost of painting the LNG Plant.[70] The Consumer Advocate projected an attrition period for Other Distribution and Storage Expense of $625,098. The Consumer Advocate projection was based upon the twelve months ended December 31, 2009 actual expense of $545,154. The Consumer Advocate applied its inflation/growth factor of 1.0213 to these expenses to arrive at $556,783 and added $68,314 to include the cost of painting the LNG Plant.[71] The Company accepted the Consumer Advocate's attrition period forecast.

The panel found that the Consumer Advocate's projection is based upon a more recent test year amount and properly grown for inflation. Thereafter, the panel voted unanimously to adopt Other Distribution and Storage Expense amount of $625,098.

V(b)13. AGL SERVICES COMPANY ALLOCATION EXPENSE

The Company's original forecast for Allocated Corporate O&M expense was $4,516,810.[72] The Consumer Advocate projected attrition period expenses for AGL Services Company Allocations Expense of $4,635,602. The Consumer Advocate's projection was based upon the twelve months ended December 31, 2009 actual expense of $5,071,197 adjusted for normalizing items.[73] The Consumer Advocate eliminated $488,007 of amounts charged to CGC for AIP expense and $189,359 of amounts charged to CGC for Long-Term Incentive Pay (LTIP) expense. Next, the adjusted amount of $4,393,831 was multiplied by the Consumer Advocate inflation/growth factor of 1.0213 to arrive at an amount of $4,487,566. Finally, the Consumer

[70] The Company expects to incur $341,571 related to the painting of the LNG plant during the summer of 2010. The Company is proposing to amortize this cost for recovery over 5 years which results in the inclusion of $68,314 in the cost of service during the attrition period. Ronald D. Hanson, Pre-Filed Direct Testimony, p. 16 (November 16, 2009).

[71] John Hughes, Pre-Filed Direct Testimony, Consumer Advocate Work Paper E-DIST (March 10, 2010).

[72] TRA FG Item No. 25 CGC Schedule 25-12 (November 16, 2009).

[73] The Consumer Advocate makes six normalizing adjustments, eliminating: $16,746 of Civic Participation Allocations, $3,880 of Promotional Advertising Allocations, $493 of Goodwill Allocations, $165,163 of Property Tax Allocations, $274,975 expense for Call Center Allocations, and $73,531 of PUCHA Tax Collection Allocations.

Advocate added back $148,036 or 50% of AIP bonus expenses resulting in a projection of $4,635,602 for the attrition period.[74]

In Rebuttal Testimony, the Company made eight adjustments to the Consumer Advocate's forecasted amount of $4,635,602. Five of the adjustments were made to reverse the Consumer Advocate's adjustments. First, the Company made an increase of $165,163 for an amount related to CGC's property tax expense. Second, the Company made a reduction of $73,531 for allocated income tax. Third, the Company increased $117,651 of AGSC allocated expenses for pension and PBOP. Fourth, the Company made a reduction of $352,911 for allocated depreciation expense. Fifth, the Company made a reduction of $129,739 for allocated Taxes Other than Income. Sixth, the Company made an increase of $96,520 for the estimated pension expense to update the actuarial determination. Seventh, the Company decreased $54,324 for the allocated Call Center costs due to the use of more recent budget dates. Eighth, the Company added back $189,359 for 100% of LTIP and $148,036 for 50% of AIP expense. Therefore, the Company projected AGL Services Company Allocation Expense of $4,741,826[75] for the attrition period.[76]

During the Hearing, the Consumer Advocate provided its latest updated Schedule 4 showing $4,394,930 for AGL Services Company Allocation Expense.[77] To arrive at this forecasted amount, the Consumer Advocate started with the normalized historical test year amount of $5,071,197, accepted the Company's correction for the Company's adjustments numbers one, two and four through seven to reach $4,625,855. Then, the Consumer Advocate eliminated $488,007 of amounts charged to CGC for AIP expense and $189,359 of amounts

[74] John Hughes, Pre-Filed Direct Testimony, Consumer Advocate Work Paper E-ALLO-2 (March 10, 2010).
[75] Ronald D. Hanson, Pre-Filed Rebuttal Testimony, Exhibit RDH-5, Schedule 5 (April 6, 2010).
[76] Ronald D. Hanson, Pre-Filed Rebuttal Testimony, Exhibit RDH-5, Schedule 8 (April 6, 2010).
[77] Revised Consumer Advocate Exhibits, Schedule 4 (April 16, 2010).

charged to CGC for LTIP expense. The residual expense of $3,948,489 was increased by the Consumer Advocate's inflation factor of 1.0213 to reach $4,032,723. Finally, the Consumer Advocate added $148,036 or 50% of AIP bonus expenses, $117,651 of AGSC allocated expenses for benefits expense other than pensions ("PBOP"), and $96,520 for the estimated pension expense.

After reviewing and verifying each adjustment for accuracy and consistency with the treatment of AIP and LTIP in the recommendations for Employee Benefits and Benefits Capitalized, the panel voted unanimously to adopt the Consumer Advocate's revised attrition period AGL Allocation Expense of $4,394,930.

V(b)14. DEPRECIATION EXPENSE

CGC projected Depreciation and Amortization Expense for the attrition period of $5,312,911. CGC filed a Depreciation Study[78] with the Direct Testimony of Rhonda Watts. The Depreciation Study recommended that the current depreciation expense should be reduced by approximately $717,000 and that mortality changes were needed for numerous accounts resulting in revised depreciation rates.[79] The Study was based on the depreciable property on the books as of December 31, 2008.[80] In Rebuttal Testimony, the Company agreed with the Consumer Advocate's calculations with the exception of the understatement of depreciation expense related to three accounts which total $111,480.

The Consumer Advocate projected Depreciation and Amortization Expense of $5,201,431[81] for the attrition period. The Consumer Advocate's projection was based upon December 31, 2009 Plant in Service balances, the net monthly plant additions and retirements[82]

[78] Rhonda Watts, Pre-filed Direct Testimony, Exhibit RW-1 (November 16, 2009).
[79] Rhonda Watts, Pre-filed Direct Testimony, p. 5 (November 16, 2009).
[80] Rhonda Watts, Pre-filed Direct Testimony, p. 5 (November 16, 2009).
[81] Terry Buckner, Pre-filed Direct Testimony, Work Paper E-DEP (March 10, 2010).
[82] Terry Buckner, Pre-filed Direct Testimony, pp. 14-16 (March 10, 2010).

and CGC's new depreciation rates[83] through April 30, 2011. During the Hearing, the Consumer Advocate presented testimony that adopted the rates from the Depreciation Study. Further, the Consumer Advocate stated that if rates were based on the reallocated reserves and TRA ordered the reallocation of the book reserves, then the $111,480 difference between its forecast and the Company's forecast would be resolved.[84]

The panel noted that the difference in the parties' forecasts for Depreciation Expense is based on the treatment of the reallocation of reserves resulting from the Depreciation Study and determined that the new rates resulting from the Depreciation Study were just and reasonable. Further, the panel found the Consumer Advocate's argument regarding reallocated reserves was persuasive, as well the argument that the $111,480 for the three accounts with a zero or negative book value should be included in Depreciation Expense. The panel agreed with the *Stipulation of the Consumer Advocate* because the rate base is inclusive of CGC's new proposed rates, will not include any depreciation for zero or negative book values, and is based upon the more recent actual plant balances at December 31, 2009. Based on these findings, the panel voted unanimously to order the reallocation of CGC's accumulated depreciation in conformity with the theoretical reserve as stated in the Consumer Advocate's Stipulation and adopt the rates resulting from the Depreciation Study and its forecast for Depreciation Expense of $5,312,911.

V(b)15. INTEREST ON CUSTOMER DEPOSITS

TRA Rule 1220-4-5-.15 allows gas utilities to accrue interest on Customer Deposits. The interest is refunded to the customer along with the security deposit after a specified time period when the customer demonstrates credit-worthiness. The Company forecasted $132,216 for the attrition period Interest on Customer Deposits. The average customer deposit balance for the

[83] Rhonda Watts, Pre-filed Direct Testimony, RW-1, Appendix A (November 16, 2009).
[84] Testimony of Terry Buckner, Hearing Transcript, pp. 580-582 (April 13, 2010).

attrition period of $2,203,593 was multiplied by the tariffed interest rate of 6.0% per annum.[85] In its pre-filed direct testimony, the Consumer Advocate agreed with the Company's attrition period forecast for Interest on Customer Deposits of $132,216. [86] The panel confirmed the Company's calculation of the average customer deposit balance for the attrition period, as well as the interest rate and voted unanimously to adopt the Company's projected Interest on Customer Deposits in the amount of $132,216.

V(c). TAXES OTHER THAN INCOME

V(c)1. PROPERTY TAXES

The Company projected Property Tax expense of $1,727,603 for the attrition period.[87] Property Tax expense for the test year was $2,857,314.[88] The Consumer Advocate projected Property Taxes of $1,603,581 for the attrition period.[89] In Rebuttal Testimony, the Company agreed with the Consumer Advocate's attrition period forecast for projected Property Taxes in the amount of $1,603,581.[90] The Consumer Advocate used actual numbers and the Company used estimated numbers.

The panel found that the Consumer Advocate's methodology to calculate Property Tax expense was reasonable because it updated the property valuation and properly prorated the tax through the end of the attrition period. The panel voted unanimously to adopt the Consumer Advocate's projected Property Taxes amount of $1,603,581.

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[85] TRA FG Item No. 25, CGC Schedule 69-6 (November 16, 2009).
[86] Terry Buckner, Pre-filed Direct Testimony, Exhibits - Schedule 3 (March 10, 2010).
[87] TRA FG Item No. 25 CGC Schedule 25-14 (November 16, 2009).
[88] Ronald D. Hanson, Pre-Filed Direct Testimony, Exhibit RDH-2, Schedule 2 (November 16, 2009).
[89] John Hughes, Pre-Filed Direct Testimony, Consumer Advocate Work Paper T-OTAX1 (March 10, 2010).
[90] Ronald D. Hanson, Pre-Filed Rebuttal Testimony, Exhibit RDH-5, Schedule 5 (April 6, 2010).

V(c)2. GROSS RECEIPTS TAX

The Company originally projected Gross Receipts Tax expense for the attrition period at $698,074.[91] The Consumer Advocate projected Gross Receipts Tax of $699,928 for the attrition period. The Consumer Advocate forecasted amount was based on one-sixth of the actual Gross Receipts Tax return as filed with the Tennessee Department of Revenue for the tax period July 1, 2009 through June 30, 2010. The remaining five-sixths of the Gross Receipts Tax was based on twelve months to date revenue as of September 30, 2009.[92] In Rebuttal Testimony, the Company agreed to the Consumer Advocate's attrition period forecast for projected Gross Receipts Taxes of $699,928.[93]

The panel approved the use of actual numbers as proposed by the Consumer Advocate. Therefore, the panel unanimously voted to adopt the Consumer Advocate's projected Gross Receipts Tax amount of $699,928.

V(c)3. FRANCHISE FEE

The Company forecasted $666,172 for the total Franchise Fee to be paid to the State and City of Chattanooga. For the attrition period, the Company projected paying $365,000 to the City of Chattanooga for the Franchise Fee and $301,172 for the State Franchise Fee.[94] The Consumer Advocate projected $675,947 for the total Franchise Fee.[95] The Consumer Advocate projected $365,000 to pay the City of Chattanooga Franchise Fee and $310,947 to pay the State Franchise Fee for the attrition period.[96] In Rebuttal Testimony, the Company agreed with the Consumer Advocate's attrition period forecast of $675,947 for the total Franchise Fee.[97] The difference between the forecasted amounts is based on net plant in service. The Company used

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[91] Ronald D. Hanson, Pre-Filed Direct Testimony, Exhibit RDH-2, Schedule 2 (November 16, 2009).
[92] John Hughes, Pre-Filed Direct Testimony, Consumer Advocate Work Paper T-OTAX7 (March 10, 2010).
[93] Ronald D. Hanson, Pre-Filed Rebuttal Testimony, Exhibit RDH-5, Schedule 5 (April 6, 2010).
[94] TRA FG Item No. 25, CGC Schedule 25-1a (November 16, 2009).
[95] John Hughes, Pre-Filed Direct Testimony, Consumer Advocate Work Paper T-OTAX0 (March 10, 2010).
[96] John Hughes, Pre-Filed Direct Testimony, Consumer Advocate Work Paper T-OTAX6 (March 10, 2010).
[97] Ronald D. Hanson, Pre-Filed Rebuttal Testimony, Exhibit RDH-5, Schedule 5 (April 6, 2010).

the balance as of June 30, 2009 and the Consumer Advocate used the balance as of December 31, 2009. The panel found that using the more recent updated net plant balance was preferable, and therefore, voted unanimously to adopt the Consumer Advocate's projected total Franchise Fee amount of $675,947.

V(c)4. TRA Inspection Fee

The Company calculated the TRA Inspection Fee based on estimated Attrition Period Gas Revenues of $87,549,763,[98] less Uncollectible Accounts Expense of $297,462 and a $5,000 exemption, resulting in net Gross Receipts of $87,247,301.[99] The first $1,000,000 of net Gross Receipts is assessed at .425% and all amounts over $1,000,000 are assessed at .325%.[100] The total TRA Inspection Fee projected by the Company for the attrition period was $285,537.[101] The Consumer Advocate also projected TRA Inspection Fees for the attrition period of $285,537.[102] After reviewing the calculations and verifying the statutory rates and methodology used by the Company and the Consumer Advocate, the panel unanimously adopted the amount of $285,537 for TRA Inspection Fees, as projected by the parties.

V(c)5. Payroll Taxes

In rebuttal, the parties agreed to the level of payroll and the proper level of payroll tax expense by applying the proper tax rates and capitalization rate to the attrition period payroll to calculate Payroll Taxes of $173,560 for the attrition period. The panel unanimously adopted $173,560 as the Payroll Tax Expense for the attrition period based upon the Payroll Expense.

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[98] Ronald D. Hanson, Pre-Filed Direct Testimony, Exhibit RDH-1, Schedule 1 (November 16, 2009).
[99] TRA FG Item No. 25, CGC Schedule 25-14 (November 16, 2009).
[100] Tenn. Code Ann. §65-4-303(c)(1).
[101] ($1,000,000 (First $1,000,000 of Gross Receipts) * 0.00425 (Accessed Rate)) + ($87,549,763 (CGC's Gross Receipts) – $1,000,000) * 0.00325 (Accessed Rate).
[102] John Hughes, Pre-Filed Direct Testimony, Consumer Advocate Work Paper E-O&M SUM (March 10, 2010).

V(c)6. ALLOCATED TAXES OTHER THAN INCOME

The Company's initial test period Allocated Taxes Other Than Income amount of $132,186 was increased by $10,502 to arrive at the attrition period Allocated Taxes Other than Income of $142,688.[103] The Consumer Advocate also projected Allocated Taxes Other Than Income for the attrition period of $142,688.[104] The panel unanimously adopted the amount of $142,688, finding that the amount was proper and the parties agreed on the forecasted amount.

V(d). INCOME TAXES

The Company and the Consumer Advocate each presented its schedules as exhibits for its calculations on the proper amount of income tax. Income Taxes include both the Tennessee Excise Tax and the Federal Income Tax. Income tax is calculated based on operating margin and expense calculations and applying statutory tax rates. Based on the statutory tax rates and other items decided in this rate case, the panel unanimously adopted Income Taxes of $2,241,272 for the attrition period after verifying the tax rates and the calculations of same.

V(e). NET OPERATING INCOME

Net Operating Income ("NOI") represents the earnings of the Company under present rates that are available after all items of the cost of providing utility service have been considered. CGC and the Consumer Advocate presented their calculations in their filed exhibits for NOI. CGC stated it required a NOI of $8,096,385. The Consumer Advocate stated that CGC would require a NOI in the amount of $6,628,385.

NOI is the operating margin minus total operating expenses. The sum of revenues (sales, forfeited discounts and other), cost of gas, gross margin on sales and service, and AFUDC results in an Operating Margin in an amount of $29,928,703. Thereafter, the following amounts are subtracted: operation and maintenance expense, interest on customer deposits, depreciation and

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[103] Ronald D. Hanson, Pre-Filed Direct Testimony, Exhibit RDH-2, Schedule 2 (November 16, 2009).
[104] John Hughes, Pre-Filed Direct Testimony, Consumer Advocate Work Paper E-O&M SUM (March 10, 2010).

amortization expense, taxes other than income tax, state excise tax and federal income tax. This results in the total operating expense in the amount of $23,004,863. The total operating expense of $23,004,863 is subtracted from the operating margin of $29,928,703 to arrive at the net operating income of $6,923,840. The panel voted unanimously to adopt NOI in the amount of $6,923,840 for the attrition period.

V(f). RATE BASE

The main difference between the Company and Consumer Advocate rate base amounts was the use of a more recent twelve month test period by the Consumer Advocate. The Consumer Advocate used the twelve month period ending December 31, 2009. In rebuttal testimony, CGC agreed with the more recent test period and filed updated exhibits along with the testimony of Ronald D. Hanson which reduced the variance to $113,203. Because the Consumer Advocate considered the variance between it and CGC as immaterial, the Consumer Advocate stipulated to a rate base for CGC in the amount of $93,818,504 for the twelve month period ending April 30, 2011.[105] The Consumer Advocate also filed revised exhibits on April 16, 2010 reflecting no difference in the rate base amounts of CGC and the Consumer Advocate.[106]

The panel unanimously voted to adopt the agreed-upon rate base of $93,818,504 for the attrition year ending April 30, 2011, based upon the following findings that the individual components are reflective of the respective amounts in this case and are necessary and reasonable.

V(f)1. UTILITY PLANT IN SERVICE AND CONSTRUCTION WORK IN PROCESS

Utility Plant in Service ("UPIS") represents the original investment cost to the Company of the assets used in providing utility service. Construction Work in Process ("CWIP") represents the cost of investment that is currently under construction and will be transferred to

[105] *Stipulation of the Consumer Advocate*, p. 2 (April 8, 2010).
[106] *Revised Exhibits*, Schedule 2 (April 16, 2010).

Plant in Service when completed. UPIS and CWIP were calculated by both parties by taking the balance at December 31, 2009, adding budgeted plant additions and retirements by month including the allocated plant of 3.12% from the parent company through April 30, 2011. The Company and the Consumer Advocate both calculated the average projected thirteen months balance for the period ending April 11, 2011 to arrive at UPIS and CWIP for the attrition period. The Company and Consumer Advocate agreed upon a net amount of $202,527,956 for UPIS and CWIP. The panel voted unanimously to adopt the agreed-upon UPIS and CWIP of $202,527,956 for the attrition year ending April 30, 2011, based upon the determination of the booked amounts in this case and upon finding that this amount is reasonable.

V(f)2. POST RETIREMENT BENEFITS OTHER THAN PENSIONS

Both the Company and the Consumer Advocate agreed on an average attrition period balance for Post Retirement Benefits Other Than Pensions ("PBOP") of $257,596. The panel voted unanimously to adopt $257,596 for PBOP because it is reasonable and is based upon the more recent December 31, 2009 amounts.

V(f)3. WORKING CAPITAL

Working Capital is the amount of funds necessary for daily expenditures and a variety of non-plant investments that are necessary to sustain ongoing operations of the utility until those expenditures can be recovered through revenues received from customers. The Company and the Consumer Advocate agreed upon $13,484,033 for Working Capital using the more recent test period amount as of December 31, 2009 because that amount is known and measurable. The panel voted unanimously to adopt the agreed upon Working Capital of $13,484,033 because it is based on more recent known and measurable amounts.

V(f)4. ACCUMULATED DEPRECIATION, CONTRIBUTIONS IN AID OF CONSTRUCTION, ADVANCES IN AID OF CONSTRUCTION, ACCUMULATED DEFERRED TAX

Contributions In Aid of Construction ("CIAOC") represents funds that are received from ratepayers for certain construction projects. These projects are undertaken when the Company's facilities are either extended or relocated at the customer's request in an area that is not likely to be economically feasible to serve under normal conditions. Accumulated Deferred Tax represents the accumulated differences between accounting or book income and taxable income. Some of these differences are permanent while others involve temporary or timing matters that will reverse in subsequent years. In the case of utilities, the major component of these differences generally involves the accelerated depreciation that is taken on utility plant for tax purposes. The tax effect of the difference between book and tax depreciation methods results in a deferral of income to later periods. These annual deferrals are then credited to this account and represent a tax savings of timing differences to the Company that will ultimately turn around. Since the ratepayers' charges are based on book depreciation amounts, the ratepayers are entitled to relief through a reduction in rate base for the total amount of Accumulated Deferred Tax.

Because the amounts were based on the later test period of the 12 months ended December 31, 2009 to project the attrition period, the Company and the Consumer Advocate agreed on the following: Accumulated Depreciation of $96,483,074; Contributions in Aid of Construction of $1,508,644; Advances in Aid of Construction of $286,394; and Accumulated Deferred Tax of $24,172,970.

Based upon its finding and determination that these amounts are reasonable and that each balance agrees with the later test period date of December 31, 2009, the panel voted unanimously to adopt the agreed upon Accumulated Depreciation of $96,483,074, Contributions in Aid of Construction of $1,508,644, Advances in Aid of Construction of $286,394 and Accumulated Deferred Tax of $24,172,970 for the attrition year ending April 30, 2011.

V(g). REVENUE CONVERSION FACTOR

The Revenue Conversion Factor represents the adjustment factor necessary to translate any surplus or deficiency in NOI into a Revenue Deficiency or Surplus that rates will be designed to produce. To produce a certain amount of revenue several factors are considered. In order to determine the proper amount of revenue needed for the Company to have the opportunity to earn a fair rate of return, it is necessary to apply a revenue conversion factor to Net income deficiency or the NOI. After this amount is calculated, it is necessary to add forfeited discounts (late payments) and subtract uncollectibles, state excise tax, and federal income tax. The Company proposed a revenue conversion factor of 1.650310% while the Consumer Advocate proposed a revenue conversion factor of 1.651701%. Based on the Company's adoption of the Consumer Advocate's forecast for base revenues, the panel found the forfeited discount ratio and uncollectible ratio used by the Consumer Advocate in the revenue conversion calculation to be appropriate and voted unanimously to adopt a Revenue Conversion Factor of 1.651701%.

V(h). RATE OF RETURN

CGC requests an overall rate of return of 8.28%.[107] The Company proposes a capital structure comprised of: 42.15% long-term debt; 6.94% short-term debt and 50.90% common equity.[108] The Company describes the methodology for determining capital structure as involving two steps. In the first step, the percentage of short-term debt in the capital structure of the parent, AGL Resources, Inc. ("AGLR"), was established at the end of the attrition period on April 30, 2011. The second step involves determining relative percentages of long-term debt and

[107] Ronald D. Hanson, Pre-filed Direct Testimony, Exhibit RDH 4 (November 16, 2009).
[108] Ronald D. Hanson, Pre-filed Direct Testimony, Exhibit RDH 4 (November 16, 2009).

equity in the capital structure by multiplying the percentage of long-term capital by the relative percentage of long-term debt and equity from a sample of peer companies.[109]

The Company estimated the short-term debt cost for AGLR to be 2.04%.[110] The estimate was derived by adjusting future estimates of the London Inter-Bank Offering Rate ("LIBOR") and by adding the estimated commercial paper spread and estimates for the costs associated with issuing short-term debt to form the estimate of short-term debt cost.[111]

The cost rate for AGLR's long-term debt is 6.03% according to CGC.[112] To determine the cost of long-term debt, calculations were made for changes in the cost of the long-term debt components in AGLR's capital structure that will occur between June 30, 2009 and the end of the attrition year in 2011. In deriving its recommended overall cost of capital of 8.28%, CGC claimed that its ROE should be set at 11.00%.[113]

The equity return was derived by implementing the Capital Asset Pricing Model ("CAPM") and a variant of the CAPM known as the Empirical CAPM ("E-CAPM"). A historical risk premium analysis of the utility industry and cost of equity estimates using the Discounted Cash Flow ("DCF") model were also performed. The Company's recommendation is based upon the results of the models listed above and the assumption that the Company has a 54% equity ratio exclusive of short-term debt.[114]

Flotation costs are the costs associated with the issuance of securities. The Company asserts that its cost of equity estimates should be increased by thirty basis points to account for flotation costs.[115] This amount is in addition to the data points already calculated.

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[109] Ronald D. Hanson, Pre-filed Direct Testimony, pp. 32-33 (November 16, 2009).
[110] Ronald D. Hanson, Pre-filed Direct Testimony, pp. 34-35 (November 16, 2009).
[111] Ronald D. Hanson, Pre-filed Direct Testimony, pp. 34-35 (November 16, 2009).
[112] Ronald D. Hanson, Pre-filed Direct Testimony, Exhibit RDH-4 Schedule 1 (November 16, 2009). *See also* Ronald D. Hanson, Pre-filed Rebuttal Testimony, Exhibit RDH-7 Schedule 1 (April 6, 2010).
[113] Dr. Roger A. Morin, Pre-filed Direct Testimony, p. 4 (November 16, 2009).
[114] Dr. Roger A. Morin, Pre-filed Direct Testimony, p. 5 (November 16, 2009).
[115] Dr. Roger A. Morin, Pre-filed Direct Testimony, p. 43 (November 16, 2009).

Based on this analysis, the Company posits that 10.5% is a conservative, yet reasonable, return on equity for CGC. However, CGC states that there is risk associated with the small size of CGC and there has been declining consumer demand and therefore, CGC advocates increasing the reasonable return on equity to 11%. Using the Company's AUA rate design proposal would result in a cost of capital of 10.75% for CGC.

The Consumer Advocate recommends an overall weighted cost of capital of 7.29% for CGC.[116] Underlying the recommendation is a capital structure comprised of 10% short-term debt, 42% long-term debt and 48% common equity.[117] The Consumer Advocate's proposed capital structure is based on the historical consolidated capital structure of AGLR.[118] Using estimates from the CAPM and DCF models, the Consumer Advocate recommends a return on equity of 9.5%.[119] In the event that CGC's decoupling plan is adopted by the TRA, the Consumer Advocate recommends a fifty basis point reduction in equity return resulting in an overall cost of capital of 7.05%.[120] The Consumer Advocate accepts the short-term and long-term debt costs proposed by CGC.[121]

In determining CGC's capital structure, the Consumer Advocate compared historical capital structures for AGLR for 2007-2009 to the recommendation of the Company. The Consumer Advocate observed that the recommendation of CGC only contains 6.04% short-term debt, while the historical average from 2007-2009 is 11.60%.[122] The Consumer Advocate concludes that the Company's figure likely represents a brief departure from the long run capital structure of AGLR. As a result, the Consumer Advocate's recommended capital structure contains 10% short-term debt, 42% long-term debt and 48% common equity.

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[116] Dr. Christopher C. Klein, Pre-filed Direct Testimony, pp. 5-6 (March 10, 2010).
[117] Dr. Christopher C. Klein, Pre-filed Direct Testimony, p. 5 (March 10, 2010).
[118] Dr. Christopher C. Klein, Pre-filed Direct Testimony, p. 5 (March 10, 2010).
[119] Dr. Christopher C. Klein, Pre-filed Direct Testimony, p. 5 (March 10, 2010).
[120] Dr. Christopher C. Klein, Pre-filed Direct Testimony, p. 6 (March 10, 2010).
[121] Dr. Christopher C. Klein, Pre-filed Direct Testimony, p. 5 (March 10, 2010).
[122] Dr. Christopher C. Klein, Pre-filed Direct Testimony, pp. 7-8 (March 10, 2010).

To estimate the cost of equity, the Consumer Advocate implements the CAPM and DCF models on data referencing CGC's corporate parent AGLR.[123] The result of the Consumer Advocate's CAPM analysis is an equity return range of 6.13% to 8% for AGLR.[124] The Consumer Advocate implements the DCF model using two different estimates of dividend growth and an estimate of earnings growth. The results of the analysis produce a range of cost of equity for AGL of 7.5% to 9.7% with a midpoint of 8.6%. The Consumer Advocate claims that its DCF and CAPM estimates, as a group, suggest a cost of equity for AGLR between 8.0% and 10.0%. The Consumer Advocate recommends 9.5% for AGLR's cost of equity to account for the possibility of increased interest rates and required returns.[125]

The Consumer Advocate agrees with CGC on flotation costs and states that such costs must be recovered, but claims that the Company overestimates the effect on cost of equity.[126] The Consumer Advocate recommends no adjustment because the required adjustment is small relative the much larger range of uncertainty surrounding the appropriate cost of equity.[127]

The Consumer Advocate asserts that the equity return for CGC should be adjusted if the TRA adopts a decoupled rate structure. The adjustment proposed by the Consumer Advocate is based upon the CAPM because CGC's risk is reduced with a decoupled rate structure. Based upon statistical analysis of data on equity returns and gas consumption, the Consumer Advocate proposes a 10% reduction of CGC's equity return if its decoupling proposal is adopted.[128] Based upon this calculation, the 10% risk reduction translates into a fifty basis point reduction in equity return for CGC.[129]

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[123] Dr. Christopher C. Klein, Pre-filed Direct Testimony, p. 9 (March 10, 2010).
[124] Dr. Christopher C. Klein, Pre-filed Direct Testimony, p. 13 (March 10, 2010).
[125] Dr. Christopher C. Klein, Pre-filed Direct Testimony, p. 14 (March 10, 2010).
[126] Dr. Christopher C. Klein, Pre-filed Direct Testimony, p. 16 (March 10, 2010).
[127] Dr. Christopher C. Klein, Pre-filed Direct Testimony, p. 16 (March 10, 2010).
[128] Dr. Christopher C. Klein, Pre-filed Direct Testimony, p. 20 (March 10, 2010).
[129] Dr. Christopher C. Klein, Pre-filed Direct Testimony, p. 21 (March 10, 2010).

The panel noted that the goal of regulatory rate setting is to ensure a fair rate of return on a company's investments while ensuring the safety and reliability of the service provided. The fair rate of return standard is established in court decisions in the *Hope* and *Bluefield* cases.[130] A fair rate of return is achieved when (1) the return is comparable to other businesses that bear similar risks; (2) the allowed return is sufficient to ensure financial integrity; and (3) the Company can attract credit at reasonable cost to meet its capital requirements.

The panel employed a three step process to determine the cost of capital. First, the capital structure of the Company was established. Traditionally, the TRA has established the capital structure for CGC by examining the capital structure of its parent company AGLR. Second, the cost of each component of the capital structure – debt and equity – was calculated. Finally, the panel computed the overall return by calculating the weighted cost of capital.

Capital Structure

The panel rejected the Company's proposed capital structure for two reasons. First, the long-term components of the Company's proposed capital structure are derived from data of peer companies, not data from the Company itself. The panel noted that the TRA prefers to use company-specific data when available, and in this proceeding such data was readily available. The primary consequence of the Company's methodology was to inflate the amount of equity in the capital structure. For example, the Consumer Advocate uses historical data and finds that the average equity ratio for AGLR is 46%. The Company's technique inflates this figure to 50.9%. Further, in response to Minimum Filing Guideline 81, the Company forecasts an equity ratio of 45.59% at the end of the attrition year in 2011.[131] Based on historical data and the Company's own projections, the panel found that the proposed capital structure contained too much equity.

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[130] *Bluefield Water Works & Improvement Co. v. P.S.C. of West Virginia*, 262 U.S. 679 (1923) and *F.P.C. v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

[131] MFG 81, Schedule 81-1, p. 3 of 8 (November 16, 2009).

The second reason the panel rejected CGC's proposed capital structure was that it does not contain adequate amounts of short-term debt. The Company projected that its capital structure will contain approximately 7% short-term debt as of April 30, 2011. The Consumer Advocate's historical analysis of AGLR's short-term debt ratio concluded that AGLR's capital structure contains at least 10% short-term debt. While acknowledging the Company's retirement of significant short-term debt in August 2009, the panel found that U.S. Securities and Exchange Commission ("SEC") documents filed in this proceeding evidenced that end-of-year 2009 short-term debt level had significantly increased. The panel found this data persuasive evidence that the Company's proposed capital structure was not reflective of its typical capital structure which contains higher levels of short term debt.

The panel also rejected the recommended capital structure of the Consumer Advocate. In reviewing the Consumer Advocate's analysis and ultimate recommendation, the panel found that the Consumer Advocate's capital structure appeared to be based upon an average of the Company's proposed capital structure and the Consumer Advocate's analysis of the historical average capital structure. Therefore, the panel rejected the Consumer's Advocate's recommendation as it was contaminated by CGC's analysis with excessive equity and insufficient short-term debt.

However, the panel found that the Consumer Advocate's averaging methodology better fits the data in this case. The panel found that for a company with a capital structure that varies throughout the year, averaging is more likely to produce a representative capital structure rather than trying to forecast a capital structure based upon known and measurable factors that are transitory rather than permanent. Thereafter, the panel adopted the historical average capital structure derived by the Consumer Advocate which contained 11.60% short-term debt, 42.34%

long-term debt and 46.06% common equity, as it represents a capital structure likely to be maintained by the Company.

Cost of Debt

The panel adopted the short-term and long-term debt costs proposed by the Company. The Consumer Advocate also accepted CGC's short-term and long-term debt cost estimates as part of its cost of capital recommendation. Thus, the panel finds that the costs of short-term debt and long-term debt for AGLR are 2.04% and 6.03%, respectively.

Equity Return

While there is no simple single-step process for determining the appropriate equity return, there are a number of factors used to determine the equity return, including: the results of the parties' models, prevailing economic conditions, rulings by other state commissions and other factors that may provide evidence about the relative risk of investing in CGC or AGLR.

The panel reviewed the CAPM estimates of the parties and specifically examined the CAPM estimates for AGLR. The panel noted that the fundamental idea underlying the CAPM is that investors demand higher returns for assuming additional risk. The CAPM produces a quantitative measure of the additional return required for bearing additional risk. The additional return needed to induce an investor to engage in a riskier investment is known as the risk premium.

To understand the results of the CAPM based upon economic conditions expected during the attrition period, the panel performed its own analysis referencing AGLR. Both parties reported a beta[132] statistic from Value Line of 0.75 for AGLR for the long-run risk premium and that was adopted by the panel. For the market risk premium, the panel used the 7.0% long-run risk premium proposed by the Company as it was derived in part from Ibbotson Associates (now

[132] The beta (β) of a stock or portfolio is a number describes the relation of its returns with that of the financial market as a whole. It measures the volatility or risk of a security in comparison to the market as a whole. Beta, as used in the CAPM model, calculates the expected return of an asset based on its beta and expected market returns.

Morningstar) data that the Authority frequently encounters in rate cases. For the risk-free return, the panel noted that testimony and data in late-filed exhibits indicate long-term interest rates are expected to rise throughout the attrition year. Based on the foregoing, the panel computed an equity return of 10.15% under forecasts that the risk-free rate will increase to 4.9%.[133] Looking slightly beyond the end of the attrition year into 2012, long-term Treasury rates are expected to climb to 5.3%, which implies an equity return of 10.55%.[134]

The panel rejected the thirty basis point adjustment to the equity that the Company makes to account for flotation costs. The TRA and its predecessor the Public Service Commission have rejected adding flotation costs to the return on equity when there is no accompanying stock issuance.[135] The Company indicated at the Hearing that it was unaware of any planned stock issuances by AGLR.[136] The panel therefore used the results of CGC excluding the impact of flotation costs when setting the equity return.

The panel was unpersuaded by the Consumer Advocate's CAPM calculations, because it uses short-term interest rates as a proxy for risk-free return. The panel found that the use of longer-term interest rates as a proxy for risk-free return is preferable because it more closely matches the expected life of a security like that of a stock or an investment in utility plant. Similarly, the panel placed little weight on the Company's DCF analysis of electric and gas utilities as it found that those utilities have significantly higher equity returns than those from the sample of natural gas companies. Alternatively, the panel placed weight on recent decisions concerning equity return made by other regulatory bodies. At the hearing, testimony established

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[133] Joint Submission of Agreed Late Filed Exhibits, Exhibit 2 (May 7, 2010).
[134] Joint Submission of Agreed Late Filed Exhibits, Exhibit 2 (May 7, 2010).
[135] *See In re: Petition of Chattanooga Gas Company for Approval of Adjustment of its Rates and Charges and Revised Tariff*, Docket No. 04-00034, Order, pp. 57-58 (October 20, 2004).
[136] Testimony of Ronald D. Hanson, Transcript of Hearing, v. I, pp. 204-205 (April 12, 2010).

that equity returns have been set slightly above 10% in cases decided by other regulatory bodies.[137]

Given the foregoing analysis and acknowledgments from the Company witness that it was not experiencing any impediments in attracting capital at the present authorized 10.2% equity return,[138] the panel found an equity return of 10.3% to be in the zone of reasonableness. The panel further found that the ROE should be reduced by twenty-five basis points under the rate design adopted in this case. Also, the panel found that the evidence presented by the parties made clear that decoupling impacts the return on equity by reducing risks, although both parties presented different views on both the direction and magnitude of the required adjustment. Having carefully reviewed the record, the panel voted unanimously to adopt the conservative estimate of a twenty-five basis point reduction to equity return based upon the rate design adopted by the panel. Finally, the panel voted unanimously to adopt 10.05% as the appropriate equity return for use in this proceeding.

Overall Rate of Return

Based on the findings above for relevant debt and equity costs, the panel calculated an overall cost of capital of 7.53% for CGC. Based on the rate design adopted by the panel, the panel voted unanimously to adopt an overall cost of capital of 7.41% finding that to be in the required zone of reasonableness.

V(i). REVENUE DEFICIENCY

Based upon rate base, net operating income, fair rate of return, and the revenue conversion factor adopted by the panel, the panel determined that the revenue deficiency for CGC is $60,068 for the attrition period.

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[137] Testimony of Dr. Roger A. Morin, Transcript of Hearing, v. III, pp. 739-740 (April 26, 2010).
[138] Testimony of Dr. Roger A. Morin, Transcript of Hearing, v. III, pp. 739-740 (April 26, 2010).

V(j). OTHER ISSUES

V(j)1. LEGAL EXPENSE FROM DOCKET NO. 07-00224

The issues of asset management and capacity release were first raised by the Consumer Advocate and CMA in Phase II of CGC's prior rate case (Docket No. 06-00175).[139] At that time, the Authority agreed with CGC's assertion that it would be more appropriate to address these issues in a separate docket. Therefore, the Authority voted to close Phase II of Docket No. 06-00175 and opened a new docket in September 2007 to consider the issues raised by the Consumer Advocate and CMA (Docket No. 07-00224).[140] The Consumer Advocate and CMA both filed for and were granted intervention in Docket No. 07-00224. In February 2008, CGC sought permission from the Authority to defer its litigation costs for possible future recovery in Docket No. 07-00224. During the two plus years of litigation, CGC incurred legal costs of $744,743.81 related to litigating the issues in Docket No. 07-00224. At the conclusion of the case, CGC petitioned the Authority to recover its costs. The CMA filed a motion to move the request for legal costs into the current rate case claiming that the TRA could allow recovery of legal expenses only in the context of a rate case. The Hearing Officer granted CMA's motion and CGC's request to recover the legal expenses was transferred into this rate case.

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[139] *In Re: Petition of Chattanooga Gas Company to Increase Rates, Including a Comprehensive Rate Design Proposal and Revised Tariff*, Docket No. 06-00175.

[140] *In Re: Docket to Evaluate Chattanooga Gas Company's Gas Purchases and Related Sharing Incentives*, Docket No. 07-00224.

CGC argued that these costs should be classified as gas costs and, as such, are recoverable through the purchase gas adjustment/actual cost adjustment ("ACA") mechanism. Therefore, CGC proposed to recover the costs through a temporary rider over a three-year period.[141] The Consumer Advocate maintained that the litigation costs are legal fees unrelated to the rate case. The Consumer Advocate argued that the TRA does not have the authority under Tennessee law to award recovery of legal fees, regardless of the docket,[142] since throughout the proceedings in Docket No. 07-00224, CGC claimed that it was not a rate case.

The panel found that CGC was required by the Authority to participate in Docket No. 07-00224 and did incur the legal expense in a complex, lengthy and protracted proceeding. Additionally, the panel found that these costs were incurred in litigating issues stemming from CGC's prior rate case docket, Docket No. 06-00175. Upon questioning by Director Roberson, Mr. Buckner acknowledged that these legal expenses would have been an allowable rate case expense in Docket No. 06-00175 if the asset management issue had been litigated within the 06-00175 docket.[143] Therefore, the panel determined that CGC should be allowed full recovery of the legal costs incurred in Docket No. 07-00224. The panel determined that the most equitable method for the Company to recover these costs would be from asset management funds. Allowing recovery of legal expenses from asset management funds is an appropriate accounting treatment for the non-recurring legal expense and also provides the Company a more timely recovery of legal expenses it has already paid. The panel determined the recovery of legal expenses should come from the consumers' share of earnings from the asset management fund, rather than through a recurring charge on their monthly bill. Thereafter, the panel voted unanimously that recovery of legal expenses should be from asset management funds.

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[141] Archie R. Hickerson, Pre-Filed Direct Testimony, p. 20 (March 5, 2010).
[142] Terry Buckner, Pre-filed Direct Testimony, p. 31 (March 10, 2010).
[143] Testimony of Terry Buckner, Transcript of Hearing, v. II, pp. 609-610 (April 13, 2010).

V(j)2. CONSUMER PROTECTION RECOMMENDATIONS

The Consumer Advocate proposes that CGC be required to implement certain "consumer protection" recommendations, including budget repayment plans, alternative address notification, and waiver of all fees in special circumstances.[144] The Company states the Consumer Advocate presented no analyses to quantify the costs that CGC would incur, no evidence to support the necessity for these recommendations and no objective definition of "special circumstances" that would enable the Company to perform its own analysis.[145] According to the Company, it currently offers a budget billing program, offers an alternate address notification, and works with its customers to address individual concerns and situations.[146] CGC opposed adopting the proposed service recommendations.

The panel found that the Company already had policies in place that address the substance of the Consumer Advocate's recommendations. Further, the record contains no evidence of any increase in customer complaints regarding billing practices of CGC. Finally, the panel noted that no adjustments to Other Revenues or Operations Expense were recommended by the Consumer Advocate to reflect the impact of fee waivers or the increased costs that the Company would incur if the Authority required CGC to adopt the proposed service recommendations. Based upon these findings, the panel voted unanimously not to adopt the service recommendations proposed by the Consumer Advocate.

V(j)3. ECONOMIC DEVELOPMENT GAS SERVICE TARIFF (EDGS-1)

CGC is proposing to establish a new economic development tariff. The purpose of the tariff is to provide economic incentives for new companies to relocate to the Chattanooga area.

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[144] Terry Buckner, Pre-filed Direct Testimony, Appendix A (March 10, 2010).
[145] Steve Lindsey, Pre-Filed Rebuttal Testimony, pp. 2-5 (April 5, 2010).
[146] *Id.*

The tariff provides discounts off the non-gas commodity charge (base rate) that are phased out over a four-year period for qualifying customers.[147] While the main thrust is to recruit new customers to the area, the tariff will also apply to existing customers who significantly expand their operations.[148] The Company states the tariff will encourage job creation, which is especially needed in the existing difficult economy.[149] The unemployment rate is near 10% in Chattanooga.[150] CGC references Atmos Energy and Chattanooga Electric Power Board as two other utilities in Tennessee with economic development tariffs.[151] Additionally, the Company clarifies that the tariff will eventually benefit other customers by spreading operational costs over a larger customer base resulting in lower customer rates. [152] Other customers will not be subsidizing the discounts because new customers will be required to meet main and service extension tariff guidelines.[153]

The panel recognized the benefits of offering economic incentives to encourage new development and the need for incentives under the current economic conditions. The panel noted that no party filed testimony opposing this tariff. The panel unanimously voted to approve the new Economic Development Gas Service Tariff ("EDGS") as filed by CGC.

V(j)4. MISCELLANEOUS TARIFF CHANGES

CGC proposed one change to its Rate Schedule F-1 (Seventh Revised Sheet No. 20A).[154] Language was added to the Billing Demand section to clarify the establishment of billing demand for service that is provided in conjunction with the companion Rate Schedule T-2.[155]

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[147] The criteria are a minimum usage of 1,000 dekatherms annually for new customers or an additional 1,000 dekatherms annually over historic usage for existing customers. The discounts are as follows: Year 1 – 40%; Year 2 – 30%; Year 3 – 20%; Year 4 – 10%; Over 4 years – 0%. Higher discounts offered up front to provide more customer savings in the first year or two of operations.
[148] Daniel J. Nikolich, Pre-Filed Direct Testimony, pp. 18-19 (November 16, 2009).
[149] Daniel J. Nikolich, Pre-Filed Direct Testimony, pp. 17-18 (November 16, 2009).
[150] Daniel J. Nikolich, Pre-Filed Direct Testimony, pp. 17-18 (November 16, 2009).
[151] Daniel J. Nikolich, Pre-Filed Direct Testimony, p. 19 (November 16, 2009).
[152] Daniel J. Nikolich, Pre-Filed Direct Testimony, p. 18 (November 16, 2009).
[153] Daniel J. Nikolich, Pre-Filed Direct Testimony, p. 19 (November 16, 2009).
[154] Refers to Commercial and Industrial Large Volume Firm Sales Service.

The panel found that the current tariff does not specify how the billing demand should be calculated for the companion rate schedule for transportation customers who have a firm backup supply. The panel also noted that no party filed testimony opposing the proposal. Therefore, the panel voted unanimously to approve the language added to Rate Schedule F-1 to clarify establishment of billing demand for service that is provided in conjunction with the companion Rate Schedule T-2.

V(k). RATE DESIGN AND ENERGY CONSERVATION

V(k)1. RATE DESIGN

The Company proposed to recover most of its revenue deficiency from residential customers. Additionally, the Company stated that because its rates are designed to recover a significant portion of its fixed costs by way of a charge per therm, when consumption decreases, CGC is not given the same opportunity to recover its costs.[156] While the Company contends conservation is good for consumers and should be promoted, it maintains that the current rate structure does not align the interests of consumers and CGC.[157] If the Company maintains the existing rate design, there is an incentive for the Company to sell more gas in order to earn its authorized return, rather than encourage conservation.[158] To alleviate this conflicting interest, the Company proposed the implementation of a revenue decoupling mechanism[159] called the Alignment and Usage Adjustment ("AUA") and stated that it will allow CGC the opportunity to

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[155] Daniel J. Nikolich, Pre-Filed Direct Testimony, p. 19 (November 16, 2009). Refers to Interruptible Transportation Service with Firm Gas Supply Backup.
[156] Steve Lindsey, Pre-filed Direct Testimony, p. 5 (November 16, 2009).
[157] Steve Lindsey, Pre-filed Direct Testimony, p. 5 (November 16, 2009).
[158] Steve Lindsey, Pre-filed Direct Testimony, p. 6 (November 16, 2009).
[159] A decoupling mechanism is generally defined as a ratemaking mechanism that is instituted to reduce or eliminate a utility's revenue being generated from sales of the commodity. A utility's revenue generation is directly tied to retail sales and any reduction in energy consumption by consumers reduces the companies' profitability. The purpose of a decoupling mechanism is to eliminate the disincentive for the utility to promote conservation efforts by eliminate the link between sales and profits and using an alternate way to generate revenue from sales.

earn a fair rate of return while also promoting conservation through its proposed energySMART conservation programs.[160]

The Company's proposed rate design will increase monthly fixed charges and implement the AUA mechanism, which is designed to normalize revenues per customer. The AUA works in a similar manner to the existing Weather Normalization Adjustment ("WNA"), but takes into consideration all effects on revenue recovery associated with usage. The Company states that approval of its rate design will eliminate the need to continue the WNA. The Company proposes that the AUA apply to the residential R-1 customer class and to the C-1, C-2 and T-3 commercial classes.[161]

The Company contends that its proposed rate design is consistent with national and local energy policies. In particular, the Company cites the 2007 amendment to the Public Utilities Regulatory Policies Act ("PURPA"), the American Recovery and Reinvestment Act of 2009 ("ARRA"), and Tenn. Code Ann. § 65-4-126,[162] which are aimed at aligning utility's financial incentives while encouraging energy efficiency and conservation.[163]

CGC provided a cost of service study for all classes of services. A cost of service study compares revenue received from the different classes of customers compared to the cost to serve each class. This helps to determine the income received on each class of customer and the rate of return on investment. CGC's study indicates that the residential service classes are earning a negative return, small commercial is earning 2.41%, medium commercial and industrial classes

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[160] Steve Lindsey, Pre-filed Direct Testimony, pp. 3-5 (November 16, 2009).
[161] Steve Lindsey, Pre-filed Direct Testimony, pp. 8-10 (November 16, 2009).
[162] Tenn. Code Ann. § 65-4-126 states:
The general assembly declares that the policy of this state is that the Tennessee regulatory authority will seek to implement, in appropriate proceedings for each electric and gas utility, with respect to which the authority has rate making authority, a general policy that ensures that utility financial incentives are aligned with helping their customers use energy more efficiently and that provides timely cost recovery and a timely earnings opportunity for utilities associated with cost-effective measurable and verifiable efficiency savings, in a way that sustains or enhances utility customers' incentives to use energy more efficiently.
[163] Steve Lindsay, Pre-filed Direct Testimony, pp. 6-7 (November 16, 2009).

are earning 25.59% and the industrial class is earning 28.29%.[164] Based upon these returns, CGC proposes to recover more costs from residential and small commercial customers through higher fixed monthly charges and less from its industrial customers.[165]

The above referenced increase in fixed charges is the first step of a two-step approach in CGC's proposed rate design. The second step is the implementation of the AUA mechanism, which is designed to normalize revenues per customer at levels used to establish base rates.[166] The Company proposes to apply the AUA mechanism to residential, commercial and transportation customers.[167] Essentially, revenue per customer would be calculated for the aforementioned customer classes in this proceeding. Each year, the actual revenue per customer would be compared to the benchmark revenue per customer. If the revenue per customer declines, then customers are surcharged to collect the difference during the subsequent year. Under this approach, the Company's WNA would cease to operate.[168] In rebuttal testimony, CGC also provided two Straight-Fixed Variable (SFV) rate designs which it contends satisfies the objectives set forth in Tenn. Code Ann. § 65-4-126.

Tenn. Code Ann. § 65-4-126 codifies the State of Tennessee's policy regarding aligning utility financial incentives with customers' efficient use of energy. CGC maintains that its comprehensive conservation program, energySMART, includes a mechanism that would remove the financial disincentives for a utility to promote the usage of natural gas by its customers.[169]

The first SFV design proposes to eliminate the recovery of fixed charges through usage charges and, instead, increase the monthly fixed charge and implement an average demand charge of $11.09. The demand charge would fluctuate based on customer usage throughout the

[164] Daniel P. Yardley, Pre-filed Direct Testimony, p. 21, Exhibit DPY-10 (November 16, 2009).
[165] Daniel P. Yardley, Pre-filed Direct Testimony, p. 15, Exhibit DPY-9 (November 16, 2009).
[166] Daniel P. Yardley, Pre-filed Direct Testimony, p. 15 (November 16, 2009).
[167] Daniel P. Yardley, Pre-filed Direct Testimony, p. 31 (November 16, 2009).
[168] Daniel P. Yardley, Pre-filed Direct Testimony, p. 30 (November 16, 2009).
[169] Chattanooga Gas Company's Post-Hearing Brief, p. 6 (May 7, 2010).

year with a higher demand charge in the winter months. This proposal would increase summer and winter monthly residential fixed rates by $1.00. It would also establish a demand charge of $5.28/month for small commercial customers and increase the existing demand charge for large commercial and transportation customers from $5.50 to $16.94. The proposed rate design would reduce the overall rates paid by interruptible customers and slightly increase rates for industrial customers with full and partial standby service.[170] In this rate design, the WNA would not be necessary.

The second SFV approach also includes an average demand charge for residential customers of $7.75/month, but still allows for recovery of 15% fixed costs through delivery charges. The demand charge would fluctuate based on customer usage throughout the year with a higher demand charge in the winter months. This proposal would increase summer and winter monthly residential fixed rates by $1.00. It would also establish a demand charge of $4.00/month for small commercial customers and increase the existing demand charge for large commercial and transportation customers from $5.50 to $11.00/month.[171] The proposed rate design would reduce the overall rates paid by interruptible customers and slightly increase rates for industrial customers with full and partial standby service. This rate design, however, would require the WNA to remain in effect.[172]

CGC also included a straight-fixed rate design, but only for residential customers. Under this approach, all usage charges would be eliminated for the recovery of fixed costs and instead residential customers would pay base rate of $29.00/month in the winter and $18.38/month during the summer and proposed to eliminate the volumetric charges included in the Company's fixed cost.

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[170] Daniel P. Yardley, Pre-Filed Rebuttal Testimony, Attachment 29-1 (April 5, 2010).
[171] Daniel P. Yardley, Pre-Filed Rebuttal Testimony, Attachment 29-2 (April 5, 2010).
[172] Daniel P. Yardley, Pre-Filed Rebuttal Testimony, pp. 30-31 (April 5, 2010).

The Consumer Advocate proposes that any change in the revenue requirement be spread uniformly across all customer classes to ensure that benefits or burdens of any rate adjustment are shared proportionately. The Consumer Advocate, however, does not recommend increases to fixed monthly charges; rather, it proposes to spread the total revenue increase to existing volumetric charges. By maintaining the recovery of a high portion of fixed costs in the delivery charges, the Consumer Advocate contends that customers will have a greater incentive to conserve.[173]

The Consumer Advocate recommends that the TRA reject CGC's proposed AUA mechanism for the following reasons:

1. Revenue decoupling is not necessary in order to meet state and federal legislation;

2. Revenue decoupling is inconsistent with traditional regulation and would lead to disincentives for cost efficiencies and risk management;

3. The AUA would transfer risk from shareholders to ratepayers with no reciprocal benefits;

4. CGC was unable to prove that its energy efficiency programs would not cause financial harm;

5. The AUA includes no ratepayer protection mechanisms;

6. The proposed energy efficiency programs do not justify the need for revenue decoupling; and

7. Negative financial impact from the energy efficiency programs could be accommodated within a lost base revenues mechanism.[174]

Nevertheless, the Consumer Advocate provided the following recommendations should the TRA decide to approve revenue decoupling:

1. Include a Return on Equity adjustment to reflect lower risk;

2. Disallow revenue recovery associated with customer growth;

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[173] Terry Buckner, Pre-filed Direct Testimony, pp. 25-26 (March 10, 2010).
[174] David E. Dismukes, Pre-filed Direct Testimony, pp. 3-4 (March 10, 2010).

3. Include a consumer protection mechanism to limit decoupling recovery to either:

    a. A level no greater than annual capacity or throughput cost savings similar to the New Jersey Approach;[175]
    b. An amount not to exceed 24% which decreases for shortfalls in reaching targeted energy savings similar to the Washington approach;[176] or

    c. A level of no more than 2% of total margin.

4. Require a review of the decoupling mechanism in no more than three years and evaluate the mechanism against energy efficiency goals;

5. Establish and define criteria for the decoupling review including energy efficiency, revenue deferrals and collections, customer usage analysis, and any other criteria defined by the TRA;

6. Require CGC to make annual filings identifying and comparing the cost of each program, number of participants, and actual savings for each program, including a cost itemization of education activities; and

7. CGC should be held to performance metrics for program costs and savings.[177]

In making its determinations regarding rate design, the panel was guided by several policy considerations and principles. The overall goal of rate design is to establish a system of rates that will enable a utility to generate sufficient revenues to cover expenses needed to operate the utility plus an equity return for investors. There are often many factors that are taken into

[175] David E. Dismukes, Pre-filed Direct Testimony, p. 80 (March 10, 2010). This refers to New Jersey's revenue decoupling program, known as Conservation Incentive Program ("CIP"). The program ties weather-adjusted margin recovery to upstream natural gas savings attained in the PGA and also effectively ties downstream (downstream of the city gate) natural gas savings to those attained upstream.

[176] David E. Dismukes, Pre-filed Direct Testimony, pp. 82-84 (March 10, 2010). This refers to the Washington Utilities and Transportation Commission ("WUTC") experience with revenue decoupling over the past twenty years. The WUTC held a decoupling workshop and found the issue so nuanced that it deferred any decisions on the matter to utility-specific requests rather than a rulemaking. After rejecting two separate requests, it did approve two pilot programs for two companies, Cascade, and Avista. However, special requirements were imposed for the decoupling plan. The Avista decoupling plan was capped at 90% of the total deferrals with actual recoveries of those deferrals were tied to specific savings targets and the plan was instituted as a pilot program with the requirement that a third-party independent review be conducted to determine its merits.

[177] David E. Dismukes, Pre-filed Direct Testimony, pp. 6-8 (March 10, 2010).

consideration when designing rates, including those related to economic and societal conditions. In addition, recently enacted federal and state laws encourage energy efficiency and energy conservation. Through such legislation, the Authority is tasked with exploring rate design alternatives that align the conservation interests of consumers, while providing utilities with the proper financial incentive for promoting energy efficiency and energy conservation.

While the panel found that the Company's proposed rate design was consistent in theory with the considerations enumerated above, the panel did not find it just and reasonable to impose a possible surcharge on customers and to shift $2.0 million of cost recovery to the residential class, while reducing rates for large industrial and interruptible customers. For this reason, the panel rejected the Company's proposed rate design, as presented in both its direct and rebuttal testimony.

The panel found that 45% of revenues are currently collected for fixed costs through volumetric charges and that customer usage has declined. As a result, it has been more difficult for CGC to maintain a revenue stream sufficient to earn its authorized rate of return. The panel also found that CGC has no incentive to encourage customers to use less gas and, in fact, the Company has an incentive to sell more gas to generate additional revenues in order to increase its earnings. Therefore, the panel determined that it is necessary to break the link of fixed cost recovery through volumetric charges. The panel determined that it was consistent with policy and legislative considerations to adopt a rate design that recovers approximately 70% of fixed costs via fixed monthly charges and only 30% from volumetric charges, with an automatic annual adjustment mechanism as proposed by the Company with safeguards as proposed by the Consumer Advocate.

Additionally, the panel found that adopting the Company's AUA mechanism for the residential class would enable the Company to maintain a more stable revenue stream, thereby

reducing financial risk for the Company. In so doing, the panel determined that the AUA mechanism should enable CGC to encourage its customers to conserve gas usage and implement methods for energy efficiencies without affecting its revenue stream. With this mechanism, revenue per customer would be calculated from the approved revenues and billing determinants and become the benchmark for comparing the actual revenues earned per customer in future years. The panel further noted that the Company's WNA would cease to operate, as the AUA mechanism takes into account all adjustments to usage including those related to weather.

The panel voted unanimously to allow the AUA mechanism to be placed into effect on a three year trial basis for the Residential (R-1) and Small Commercial (C-1) classes. At the end of the three year trial period, the Company shall provide a report to the Authority on the AUA mechanism, including its impact and effect on both consumer classes and the Company. The report shall provide recommendations as to whether the AUA mechanism should be continued. Further, the panel voted unanimously to adopt the 2.0% annual cap on margin accruals within the AUA mechanism for the R-1 and C-1 classes, as recommended by the Consumer Advocate.

The panel found that the Company's current methodology for recovering the portion of fixed charges through volumetric rates by charging customers less per 100 cubic feet (ccf) when increasing usage did not provide encouragement for conservation. Therefore, the panel voted unanimously to replace the Company's declining block volumetric rate structure with a single volumetric rate of $0.11591 per therm.

Based on the prior decisions regarding rate design, the panel voted unanimously to increase the R-1 Class fixed monthly charges from $10.00 to $13.00 in the summer and from $12.00 to $16.00 in the winter. The panel also voted unanimously to increase the residential reconnection charge from $50.00 to $65.00. These rates are based upon the Consumer Advocate's billing determinants for customer bills and the Company's proposed usage which

was agreed to by the Consumer Advocate. The panel noted that these decisions did not include any rate changes to any other customer classes in recognition, but not adoption, of the class of service cost study.

V(k)2. ENERGY CONSERVATION

With adoption of its proposed rate design, CGC commits to promote energy conservation through its energySMART programs, consisting of the Community Outreach and Customer Education Program and additional energy conservation initiatives including the Programmable Thermostat Program, the Low-Income Home Weatherization Program, and programs aimed at encouraging consumers to install high-efficiency gas water heaters and furnaces.[178]

With regard to the Community Outreach and Customer Education Program, the Company planned to utilize several methods of communication to reach consumers including newspapers, magazines, radio, television, billboards, digital media, direct mail and bill inserts.[179] Also, the Company proposes to develop literature to distribute directly to consumers by means of its own field service representatives, along with HVAC contractors and plumbers. CGC also planned to explore establishing collaborative relationships with retailers of natural gas appliances, with the possibility of holding homeowner clinics.[180] By utilizing this program, the Company asserted that a consumer could save up to $280 annually.[181] CGC also proposed several programs for its commercial customers to improve energy efficiency, which could potentially result in $500 in annual savings.[182]

For its Low-Income Home Weatherization plan, the Company proposed to partner with local agencies that oversee the Weatherization Assistance Program such as the Department of Human Services. The Company stated that working with these agencies that already have

[178] Steve Lindsey, Pre-filed Direct Testimony, p. 10 (November 16, 2009).
[179] Donna Peeples, Pre-filed Direct Testimony, p. 8 (November 16, 2009).
[180] Donna Peeples, Pre-filed Direct Testimony, p. 9 (November 16, 2009).
[181] Donna Peeples, Pre-filed Direct Testimony, p. 10 (November 16, 2009).
[182] Donna Peeples, Pre-filed Direct Testimony, p. 11 (November 16, 2009).

reliable sources and methods for providing assistance to low-income households should eliminate a substantial portion of expenses that the Company would otherwise incur for developing new programs. Eligible participants must qualify within existing federal and state programs to be eligible. In addition to weatherization measures (including insulation upgrades and air and duct sealing), appliance and equipment repair/replacement will be provided free of charge to qualifying consumers.[183]

CGC also proposed rebates to residential customers that replace energy inefficient water heaters and furnaces. According to the Company, it is possible for a consumer to receive a rebate of up to $500 for an energy efficient furnace and $150 for an energy efficient water heater. Similar rebates will be offered to commercial users for Commercial Space Heating Units/Boilers and tankless water heaters.[184] Finally, CGC proposed to provide residential consumers with a free programmable thermostat so that consumers can automatically reduce the thermostat temperature setting when no one is home or when it is not necessary to maintain a high home temperature, thereby reducing natural gas usage. The Company estimated that homeowners could save an average of $180 annually by properly setting programmable thermostats.[185]

The Company utilized the following five standard cost/benefit analysis tests for evaluating its energySMART Program:[186]

1. The Participant Test which determines whether a program is cost effective for the consumer taking part in the program;

2. The Ratepayer Impact Measure Test which determines the impact a program will have on non-participating consumers;

3. The Total Resource Cost Test which is designed to measure the cost-effectiveness from a societal standpoint.

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[183] Donna Peeples, Pre-filed Direct Testimony, pp. 12-13 (November 16, 2009).
[184] Donna Peeples, Pre-filed Direct Testimony, pp. 15-16 (November 16, 2009).
[185] Donna Peeples, Pre-filed Direct Testimony, p. 16 (November 16, 2009).
[186] Daniel J. Nikolich, Pre-filed Direct Testimony, pp. 3-4 (November 16, 2009).

4. The Program Administrator Cost Test which is designed to measure a program's cost-effectiveness as a utility resource alternative; and

5. The Societal Benefit Test, while closely resembling the Total Resource Cost Test, also incorporates higher marginal costs to reflect societal costs of more expensive resources.

The tests were specifically applied to the following energySMART programs:[187]

1. Residential free Programmable Thermostat;
2. Residential Low Income Weatherization Grants;
3. Residential Space Heating High Efficiency Furnace/Boiler Incentive;
4. Residential Tankless Water Heater Incentive;
5. Residential High Efficiency Storage Water Heater;
6. Commercial Food Service Equipment Incentive;
7. Commercial Space Heating Furnace/Boiler Incentive;
8. Commercial Tankless Water Heater Incentive;
9. Commercial High Efficiency Storage Water Heater Incentive; and
10. Commercial Booster Water Heater Incentive.

CGC claimed that the overall programs pass the Participant Cost Test, the Total Resources Cost Test, the Program Administrator Test, and the Societal Benefit Test. While the Company admitted that the Rate Impact Measure ("RIM") Test[188] is not cost effective given the assumptions used, CGC stated that an increase in gas costs would push the results to positive.[189]

The Company proposed to recover the costs of the Low Income Weatherization Program ($198,000) from profits generated under its Asset Management Agreement. The annual costs of the remaining programs is $792,000 which takes into account Company-provided funding of $100,000 in the first year, $50,000 in the second year, and $25,000 in the third year.[190] CGC proposed to recover the $792,000 of program costs through a monthly therm charge to the Residential-1 class, Commercial-1 and 2 classes, and the Transportation 3 class. The recovery of

[187] Daniel J. Nikolich, Pre-filed Direct Testimony, pp. 4-5 (November 16, 2009).
[188] Daniel J. Nikolich, Pre-filed Direct Testimony, p. 4 (November 16, 2009). This test determines the impact that a program will have on non-participating rate payers.
[189] Daniel J. Nikolich, Pre-filed Direct Testimony, pp. 15-16 (November 16, 2009).
[190] Daniel J. Nikolich, Pre-filed Direct Testimony, Exhibit DJN-1 (November 16, 2009).

these costs would be projected by the Company and true-up at the end of the year for any over-or under-recovery of program costs.[191]

The Consumer Advocate contended that the Company's cost analysis supporting its proposed energy efficiency programs include mechanical and input errors, and faulty assumptions which yield unreliable results.[192] Moreover, according to the Consumer Advocate, the Company's own analysis found that every residential and commercial measure failed the non-participant or RIM test, except programmable thermostats. In sum, the Consumer Advocate recommended that the energy efficiency programs be rejected. Furthermore, the Consumer Advocate recommended that the Education and Outreach program be rejected because it lacks sufficient details, plans and goals.[193]

Tenn. Code Ann. §65-4-126 requires that TRA approve energy efficiency programs that are: 1) cost-effective; 2) measurable; and 3) verifiable in sustaining or enhancing incentives for consumers to use energy more efficiently. The panel found that the Company proposed an ambitious and forward-thinking program called energySMART. Nevertheless, the panel was not persuaded that all of the proposed programs met the statutory criteria. Therefore, in conformance with the statute, the panel voted to adopt only two parts of CGC's energySMART Program: the Programmable Thermostat measure and a more limited Education and Outreach component than proposed by the Company. Regarding the latter, the panel voted unanimously to approve only half of the proposed funding, $150,000, for CGC's proposed Education and Outreach program. The panel noted that with the shareholder money pledged, the first three years of the energySMART Program will cost ratepayers a total of $275,000, or $91,666 annually over three years. The panel found that the two programs in the amounts outlined above fit the cost-effective standard of the statute. The panel further voted unanimously that these

[191] Daniel J. Nikolich, Pre-filed Direct Testimony, p. 16 (November 16, 2009).
[192] David E. Dismukes, Pre-filed Direct Testimony, p. 5 (March 10, 2010).
[193] David E. Dismukes, Pre-filed Direct Testimony, pp. 5-6 (March 10, 2010).

initiatives be funded through revenues generated by CGC's asset manager and be collected through CGC's Interruptible Margin Credit Rider ("IMCR") tariff.

As to the measurability standard, the panel directed TRA Staff to work with the National Regulatory Research Institute ("NRRI") to establish a set of measures sufficient to evaluate the Programmable Thermostat and Education and Outreach components. The panel noted that NRRI is a nationally recognized research organization that can provide the TRA Staff with valuable insights and assistance in crafting an instrument that can be used as a model not only for the instant docket, but for other energy conservation programs. Recent state legislation has directed that the results of energy conservation programs be measurable. NRRI has the expertise to assist the TRA Staff in establishing adequate measures to evaluate energy conservation programs. Because energy conservation programs ultimately benefit consumers, it is reasonable to have NRRI conduct the necessary research and have it funded by consumers that will benefit from such research. The panel voted unanimously that the cost of NRRI's assistance, not to exceed $25,000, shall be funded from the consumers' share of the asset management revenues.

As to the verifiability standard, the panel voted unanimously that the Company be required to file annual reports concurrent with its IMCR tariff detailing the costs incurred with the programmable Thermostat Program and a detailed accounting of all money spent on its Education and Outreach Programs, as well as, the program evaluation created by the TRA Staff. Copies of these documents shall also be filed concurrently with the Consumer Advocate.

VI. PURPA STANDARDS

The Public Utility Regulatory Policies Act ("PURPA") was enacted in 1978 to "encourage (1) conservation of energy supplied by gas utilities; (2) the optimization of the efficiency of use of facilities and resources by gas utility systems; and (3) equitable rates to gas

consumers of natural gas."[194] PURPA originally contained two federal standards for gas utilities; two additional standards were added by the Energy Policy Act of 1992. The PURPA requirements apply to gas utilities with total annual retail sales greater than ten billion cubic feet using a baseline year of the calendar year immediately preceding passage of the 2007 Energy Act.[195] PURPA requires a "state regulatory authority (with respect to each gas utility for which it has ratemaking authority)" to adopt each standard or to state in writing that it has determined not to adopt such a standard.[196] If a state regulatory authority declines to implement a standard, it must state in writing the reason for the decision and make that statement available to the public.[197]

The Energy Independence and Security Act of 2007 ("2007 Energy Act") amended PURPA by adding two additional standards that a state regulatory authority must consider and determine the appropriateness of implementing those standards with respect to each gas utility for which the agency has ratemaking authority. These additional standards are codified at 15 U.S.C. § 3203(b)(5) through (6). In addition to the requirements of the 2007 Energy Act, the recently passed ARRA requires that state regulatory authorities seek to implement policies similar to those described in the 2007 Energy Act in order to receive stimulus funds.[198]

The 2007 Energy Act created the following new PURPA standards:

(5) Energy efficiency.--Each natural gas utility shall—

(A) integrate energy efficiency resources into the plans and planning processes of the natural gas utility; and

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[194] 15 U.S.C. § 3201(a).
[195] 15 U.S.C. § 3201(b).
[196] 15 U.S.C. § 3203(c)
[197] *Id.*
[198] ARRA, Title IV Sec. 410 (a)(1): The applicable State regulatory authority will seek to implement appropriate proceedings for each electric and gas utility, with respect to which the State regulatory authority has ratemaking authority, a general policy that ensures that utility financial incentives are aligned with helping their customers use energy more efficiently and that provide timely cost recovery and a timely earnings opportunity for utilities associated with cost-effective measurable and verifiable efficiency savings, in a way that sustains or enhances utility customers' incentives to use energy more efficiently.

(B) adopt policies that establish energy efficiency as a priority resource in the plans and planning processes of the natural gas utility.

(6) Rate design modifications to promote energy efficiency investments.—

(A) In general.--The rates allowed to be charged by a natural gas utility shall align utility incentives with the deployment of cost-effective energy efficiency.

(B) Policy options.--In complying with subparagraph (A), each State regulatory authority and each nonregulated utility shall consider—

(i) separating fixed-cost revenue recovery from the volume of transportation or sales service provided to the customer;

(ii) providing to utilities incentives for the successful management of energy efficiency programs, such as allowing utilities to retain a portion of the cost-reducing benefits accruing from the programs;

(iii) promoting the impact on adoption of energy efficiency as 1 of the goals of retail rate design, recognizing that energy efficiency must be balanced with other objectives; and

(iv) adopting rate designs that encourage energy efficiency for each customer class.[199]

In Docket No. 09-00065, the TRA considered adoption of PURPA standards created via amendments in the 2007 Energy Act related to energy efficiency and rate design for natural gas utilities. The Directors unanimously adopted the Report and Recommendation of the Hearing Officer that the PURPA standards should be addressed in individual, company-specific dockets.[200]

With respect to PURPA Standard 5 concerning energy conservation, the Company maintained that it had already integrated energy efficiency resources into its planning and had established it as a priority in the planning process. The Company noted that conservation plays a role in determining the need for gas supply contracts and assets.[201] The Company further noted that as conservation programs mature, additional efficiencies may make more supply resources

[199] 15 U.S.C. § 3203(b)(5)-(6).

[200] In re: Appropriateness of Implementation of PURPA Standard 5 (Energy Efficiency) and Standard 6 (Rate Design Modification) for Piedmont Natural Gas Company, Chattanooga Gas Company, and Atmos Energy Company, Docket No. 09-000065, *Order Declining to Adopt Standards in Instant Docket*, p. 4 (January 11, 2010).

[201] Archie Hickerson, Pre-filed Direct Testimony, p. 22 (March 5, 2010).

available to address future needs.[202] The positions of parties with respect to the PURPA standard on rate design are set forth above in Section V(k)1.

The panel noted that Standards 5 and 6 sought to ensure that energy efficiency was a primary goal for public gas utilities by requiring that (1) energy efficiency be included in each utility's planning processes and (2) utilities' financial incentives be aligned with cost-effective deployment of energy efficiency. After careful consideration of PURPA standards 5 and 6, the panel found that existing state authority is sufficient to provide oversight of the Company's rate design and energy efficiency planning. Therefore, the panel voted unanimously to decline to adopt PURPA standards 5 and 6 for Chattanooga Gas Company.

VI. RESEARCH AND DEVELOPMENT FUNDING

The panel found in favor of CGC's position that it is appropriate for ratepayers to fund consumer-oriented research into natural gas conservation devices and strategies. Therefore, the panel voted unanimously to direct the Company to provide $20,000 annually during the three year trial period from asset management funds, when available, to fund such consumer-oriented research. The Company shall file a report with the TRA detailing the contribution to the natural gas research organization of its choice within sixty days from the issuance of the Order in this docket.

[202] *Id.*

IT IS THEREFORE ORDERED THAT:

1. The rates filed by Chattanooga Gas Company on November 16, 2009 are denied;

2. For purposes of the rates herein, the annual test period shall be the historical test period for the twelve months that ended December 31, 2009, with adjustments for attrition through April 30, 2011;

3. For purposes of the rates herein, the rate base is $93,818,504 and the net operating income is $6,923,840;

4. For purposes of the rates herein, the capital structure of 11.60% short-term debt, 42.34% long-term debt and 46.06% common equity. The cost of capital rates consist of 2.04% short-term debt, 6.03% of long-term debt. The panel adopted an equity return of 10.3% and reduced the equity return by 25 basis points to an amount of 10.05% as a result of adopting the AUA mechanism;

5. For purposes of the rates herein, the overall cost of capital shall be 7.41%.

6. For purposes of the rates herein, the Revenue Conversion Factor is 1.651701, resulting in a Revenue Deficiency of $60,068, the amount needed for the Company to earn a fair return on its investment during the attrition year;

7. The Alignment and Usage Adjustment ("AUA") mechanism shall be placed into effect on a three-year trial basis for the Residential (R-1) and Small Commercial (C-1) classes. At the end of the three-year trial period, the Company shall provide a report to the Authority on the AUA mechanism, including its impact and effect on both consumers and the Company and provide recommendations whether the AUA mechanism should be continued.

8. The margin accruals within the AUA mechanism for R-1 and C-1 classes shall have a 2.0% annual cap.

9. The Company shall replace the declining block volumetric rate structure with a single volumetric rate of $0.11591 per therm.

10. The R-1 Class fixed monthly charges shall be $13.00 in the summer and $16.00 in the winter.

11. The residential reconnection charge shall be $65.00.

12. The Programmable Thermostat measure and funding of $150,000 for Education and Outreach Programs shall be funded through revenues generated by CGC's asset manager and be collected through CGC's IMCR tariff.

13. Language shall be added to Rate Schedule F-1 to clarify the establishment of billing demand for service that is provided in conjunction with the companion Rate Schedule T-2.

14. The full amount of legal costs from Docket No. 07-00224 shall be recovered and such recovery shall be from asset management funds.

15. The new Economic Development Gas Service Tariff (EDGS-1) is approved as filed.

16. Chattanooga Gas Company shall file tariffs with the Tennessee Regulatory Authority that are designed to produce an increase of $60,068 in revenue for service rendered and any tariffs necessary to be consistent with this Order,

17. Chattanooga Gas Company shall provide $20,000 annually during the three-year trial period from asset management funds, when available, to fund consumer-oriented research into natural gas conservation devices and strategies and shall file a report with the Tennessee Regulatory Authority detailing the contribution to the natural gas research organization of its choice within sixty days from the issuance of the Order in this docket.

18. Any party aggrieved by the Authority's decision in this matter may file a Petition for Reconsideration with the Authority within fifteen days from the date of this Order; and

19. Any party aggrieved by the Authority'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.

Sara Kyle, Chairman

Eddie Roberson, Director

Mary Freeman, Director

BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

November 4, 2015

IN RE:	)	
	)	
PETITION OF ATMOS ENERGY CORPORATION	)	**DOCKET NO.**
FOR A GENERAL RATE INCREASE UNDER T.C.A.	)	**14-00146**
65-5-103(a) AND ADOPTION OF AN ANNUAL RATE	)	
REVIEW MECHANISM UNDER T.C.A. 65-5-103(d)(6)	)	

ORDER APPROVING SETTLEMENT

This matter came before Vice Chairman David F. Jones, Director Kenneth C. Hill and Director Robin Bennett of the Tennessee Regulatory Authority (the "Authority" or "TRA"), the voting panel assigned to this docket, at a scheduled Hearing held on May 11, 2015 for consideration of the *Stipulation and Settlement Agreement* ("*Settlement Agreement*" or "*Agreement*") filed on April 29, 2015, by Atmos Energy Corporation ("Atmos" or the "Company") and the Consumer Advocate and Protection Division of the Office of the Attorney General ("Consumer Advocate").

BACKGROUND AND *PETITION*

On November 25, 2014, Atmos filed a *Petition* requesting a general rate increase and Authority approval of an annual rate review mechanism pursuant to Tenn. Code Ann. § 65-5-103(d)(6).[1] The Company's previous rate case in Docket No. 12-00064 was resolved by a settlement agreement between Atmos and the Consumer Advocate, which was approved by the Authority.[2] The previous rate case in Docket No. 12-00064 was resolved prior to the General Assembly's enactment of 2013 Tenn. Pub. Acts 245, which provided, among other things,

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[1] *Petition*, pp. 1-2 (November 25, 2015).
[2] *See In re: Petition of Atmos Energy Corporation for a General Rate Increase*, Docket 12-00064, *Order Approving Settlement* (December 4, 2012).

specific statutory requirements for alternative ratemaking mechanisms. In Docket No. 14-00081, the Company sought to implement an alternate annual rate adjustment mechanism utilizing the previous rate case settlement in Docket No. 12-00064 as an underlying basis for rate adjustments going forward.[3] Following the filing of a motion to dismiss by the Consumer Advocate and subsequent hearing, the Authority dismissed the Company's request as the settlement agreement in Docket No. 12-00064 did not provide for the adoption of any ratemaking methodology or agreed upon formulas that would allow for the establishment of an annual rate review mechanism in accordance with Tenn. Code Ann. § 65-5-103(d)(6).[4]

The *Petition* in this docket was filed by the Company to set rates utilizing and adopting methodologies so as to allow the implementation of an annual rate review mechanism in accordance with statutory requirements.[5] The *Petition* sought an increase in rates of $5.89 million within the confines of a traditional rate case based in part upon a request for an authorized return on equity of 10.7%.[6] The *Petition* further requested approval of a proposed Annual Review Mechanism tariff ("ARM tariff") to implement procedures for an annual rate review mechanism pursuant to Tenn. Code Ann. § 65-5-103(d)(6). The Company proposed to make its first annual review filing in September of 2015 with any rate adjustment going into effect on January 1, 2016, and each January 1 thereafter.[7]

At the regularly scheduled Authority Conference held on December 1, 2014, the panel voted unanimously to convene a contested case proceeding and to appoint the Authority's General Counsel or her designee to act as Hearing Officer to prepare this matter for hearing, including establishing a procedural schedule, entering a protective order, and ruling on

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[3] *See In Re: Petition of Atmos Energy Corporation to Establish An Annual Rate Review Mechanism Pursuant to Tenn. Code Ann.* § 65-5-103(d)(6), Docket No. 14-00081, *Petition*, pp. 2-4 (August 28, 2014).
[4] *Id., Order Granting Consumer Advocate's Motion to Dismiss*, pp. 15-18 (December 8, 2014).
[5] *Petition*, p. 1 (November 25, 2014).
[6] *Id.* at 4.
[7] *Id.* at 4-5.

intervention requests and discovery issues. The Consumer Advocate filed a petition to intervene on December 23, 2014, which was subsequently granted on January 7, 2015.[8]

The initial filing of the *Petition* initiating a general rate case while seeking the approval and implementation of the ARM tariff simultaneously raised an issue of conflicting statutory deadlines.[9] Under Tenn. Code Ann. § 65-5-103(a) and (b), a general rate case has a statutory deadline requiring resolution by the Authority within six months with an allowance of an additional three months during which time the public utility may seek to place the proposed rates into effect under bond pending a decision by the Authority. On the other hand, alternative ratemaking proposals filed pursuant to Tenn. Code Ann. § 65-5-103(d)(6)(C) such as the Company's ARM tariff, must be considered by the Authority within 120 days of filing, a statutory deadline the Hearing Officer concluded cannot be waived. [10] Thus, the deadline for the Authority's consideration of the ARM tariff would conclude prior to the Authority's consideration of the *Petition's* request for rate relief in a rate case and subsequent adoption of rate-making methodologies, placing the ARM tariff proposed in the *Petition* in the same circumstances as found in Docket No. 14-00081.

Following the status conference on January 7, 2015, and at the suggestion of the Hearing Officer, the Company filed a notice to temporarily withdraw the ARM tariff from consideration without prejudice.[11] On February 18, 2015, Atmos filed a notice reinstating the *Petition's* request for the Company's proposed ARM tariff in anticipation of the Authority's scheduled deliberations on June 15, 2015.[12] During the course of the proceeding, the Consumer Advocate

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[8] *Order Granting Consumer Advocate's Petition to Intervene*, pp. 3-4 (January 7, 2015).
[9] *Order Establishing Procedural Schedule*, pp. 2-3 (January 12, 2015).
[10] *Id.* at 3.
[11] *Notice of Withdrawal Without Prejudice For Later Reinstatement of Certain Portions of Petition and ARM Tariff* (January 13, 2015).
[12] *Reinstatement of Certain Portions of Petition and ARM Tariff Previously Withdrawn Without Prejudice For Later Reinstatement* (February 18, 2015).

and the Company engaged in discovery and filed pre-filed testimony in anticipation of a contested hearing before the panel scheduled for May 11, 2015.

On April 29, 2015, the Company and the Consumer Advocate filed the *Settlement Agreement*. The TRA Staff issued data requests and received responses from both parties concerning different aspects of the *Agreement*.

THE *SETTLEMENT AGREEMENT*

I. The Rate Case

The Company's *Petition* requested an increase in rates of $5.89 million. The *Settlement Agreement* reduces the attrition period revenue deficiency from $5.9 million (an increase in revenue of 3.9%) to $.71 million (an increase in revenue of 0.5%).[13] An outline of the overall consensus of the *Agreement* resulting in the agreed upon deficiency is presented as follows:

1. Required operating income of $19,167,175;
2. Rate base of $247,958,277;
3. Overall rate of return of 7.73% on rate base;
4. Return on common equity of 9.80%;
5. Capital structure consisting of 5.01% short-term debt, 41.86% long-term debt, and 53.13% equity;
6. Cost of short-term debt of 1.07%;
7. Cost of long-term debt of 5.90%; and
8. Attrition period revenue deficiency of $711,472.[14]

Schedules outlining the revenues and cost of service components agreed to by the Parties are attached as Attachment A to the *Settlement Agreement*. The schedules are supported by workpapers outlining the methodology employed in arriving at the attrition year revenue and cost components. Attachment B of the *Agreement* contains the proposed tariff rates with an effective date of June 1, 2015. The Parties agree the revenue deficiency and rates reflected in Attachments A and B are appropriate and reasonable for the limited purpose of resolving the proceeding.[15]

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[13] *Settlement Agreement*, p. 3 (April 29, 2015).
[14] *Id.* at 4; *Joint Response to TRA First Data Request to Atmos Energy Corporation and Consumer Advocate and Protection Division of the Office of the Attorney General*, p. 2 (May 1, 2015).
[15] *Id.*

The Company and the Consumer Advocate state that the *Settlement Agreement* is the product of "give and take" negotiations and agree that the Settlement Agreement shall not have any precedential effect.[16] The Parties further jointly requested that the Authority adopt the methodologies used in the *Settlement Agreement* for the limited purpose of implementing an annual rate review mechanism pursuant to Tenn. Code Ann. § 65-5-103(d)(6).

II. The ARM Tariff

The Parties agreed upon the terms of the ARM tariff as reflected in the revised ARM tariff page 34.5 submitted on May 1, 2015, superseding the tariff page 34.5 filed in Attachment C of the *Settlement Agreement*.[17] The *Petition's* original proposed ARM tariff was based on the Company's budgeted information, with no reconciliation between budgeted and actual information in future filings.[18] The changes to the ARM tariff provided in the *Settlement Agreement* include a reconciliation process utilizing actual expenses and capital investments.[19] The Company will make an Annual Filing no later than February 1 of each year. On or before September 1st of each year the Company will file an Annual Reconciliation to the Authorized Return on Equity. The proposed reconciliation will true-up actual amounts to the Company's authorized return on equity for the forward-looking test year that immediately completed and include interest at the overall cost of capital compounded for two years.[20]

The *Settlement Agreement* imposes requirements for reviewing both the Annual ARM tariff and the reconciliation. As part of the *Settlement Agreement*, the Company is required to file a Variance Report which would identify and explain differences between the current year and the

[16] *Id.* at 30.
[17] *Joint Response to TRA First Data Request to Atmos Energy Corporation and Consumer Advocate and Protection Division of the Office of the Attorney General*, p. 3 (May 1, 2015).
[18] William H. Novak, Pre-filed Direct Testimony, p. 40 (April 7, 2014).
[19] *Settlement Agreement*, p. 26 (April 29, 2015).
[20] *Id.* at 25-27.

prior year exceeding 5% and $30,000.[21] From this Variance Report, the CAPD and/or the Authority can request additional information and an explanation from the Company which will be provided by the Company within ten business days.[22]

As part of the *Agreement*, an attestation is required from a Company officer affirming 1) that the Company's Annual ARM Filing has been prepared in accordance with the Approved Methodologies, or that any deviation from or the resolution of any ambiguities in the Approved Methodologies has been affirmatively disclosed and explained in a document attached to an affidavit; 2) disclose any new methodologies it has used; 3) that all new matters have been disclosed; 4) that the Variance Report, described above, includes all matters required; 5) that no disallowed items have been included in the filing; 6) that there have been no additions, deletions or modifications to the accounts or subaccounts; and 7) that there have been no changes in the method of accounting or estimating any account or subaccount.[23]

As modified, the ARM filing will use the twelve-month period ending September 30th of each year prior to the Annual Filing Date as the test year with rates to be established based on a forward-looking test year for the twelve-month period ending May 31st of each following year.[24] As required by Tenn. Code Ann. § 65-5-103(d)(6)(C), the Parties agreed that the Company will use the authorized return on equity as established in this docket. As part of the *Agreement*, the Parties agreed that Atmos Energy may opt into an annual review of its rates pursuant to Tenn. Code Ann. § 65-5-103(d)(6), with the ARM tariff as the method for purposes of resolving this proceeding.[25]

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[21] *Id.* at 27-28.
[22] *Id.* at 28.
[23] *Id.* at 6-7.
[24] *Id.* at 4-5, 8.
[25] *Id.* at 4.

The *Settlement Agreement* proposes that any rate adjustments resulting from an ARM filing go into effect for bills rendered on or after June 1st.[26] The *Agreement* proposes any revenue deficiency or sufficiency shall be distributed proportionate to the current margin of each class with the current base and volumetric rates consistent with Schedule 11-3 of the *Settlement Agreement*, excluding Special Contract customers.[27] The *Agreement* requires the Company to notify the Authority and the Consumer Advocate at least 120 days prior to any termination, renewal or rate related alteration of any Special Contract and seek approval for any such change.[28]

The *Settlement Agreement* further provides that Atmos may file a depreciation study with the Authority for review and request that the depreciation rates proposed therein be included in the Company's next ARM filing.[29] The *Agreement* proposes that in the event the Company conducts a depreciation study, the study will be provided to the Consumer Advocate and filed with the Authority within thirty (30) days of completion of the study rather than submitting the study concurrent with or as part of an ARM filing.[30] The Parties agree that following appropriate discovery and the opportunity for rebuttal by any intervening party and consideration for approval by the Authority, any new depreciation rates approved by the Authority shall be applied in the Company's next subsequent ARM filing. [31]

THE HEARING

The Hearing in this matter was held before the voting panel on May 11, 2015, as noticed by the Authority on April 30, 2015. Participating in the Hearing were the following parties and their respective counsel:

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[26] *Id.* at 5-6.
[27] *Id.* at 8.
[28] *Id.*
[29] *Id.* at 18-19.
[30] *Id.* at 18.
[31] *Id.* at 18-19.

Atmos Energy Corporation – A. Scott Ross, Esq., Neal and Harwell, PLC, 2000 One Nashville Place, 150 Fourth Ave. North, Nashville, TN 37219.

Consumer Advocate and Protection Division – Wayne Irvin, Esq. and Vance Broemel, Esq., Office of the Attorney General, 425 5th Ave. North, John Sevier Building, P.O. Box 20207, Nashville TN 37202.

During the Hearing, Atmos and the Consumer Advocate indicated they were in agreement with the *Settlement Agreement* and the *Agreement* was presented to the panel. Members of the public were given an opportunity to offer comments, but no one sought recognition to do so.

FINDINGS AND CONCLUSIONS

Following the Hearing on the proposed *Settlement Agreement*, the panel deliberated the matter on May 11, 2015. Based upon the evidence in the record and the agreed upon terms of the *Settlement Agreement*, the panel found that the overall rate increase of $711,000 annually proposed by the Parties is just and reasonable and provides the necessary level of revenues to allow Atmos to continue to provide safe and reliable service. Furthermore, the panel found that the underlying methodologies employed by the parties in the *Settlement Agreement*, as reflected in the workpapers and schedules contained in Attachment A of the *Agreement*, as a whole are based upon sound ratemaking principles applicable to the unique circumstances and settlement of this case. The panel noted that the average customer's bill will increase by $0.26 per month.

The *Settlement Agreement* also proposed an annual rate review tariff pursuant to Tenn. Code Ann. § 65-5-103(d)(6). The panel considered the proposed ARM tariff as modified by the *Settlement Agreement*. Tenn. Code Ann. § 65-5-103(d)(6) states:

> (6)(A) A public utility may opt to file for annual review of its rates based upon the methodology adopted in its most recent rate case pursuant to § 65-5-101 and subsection (a), if applicable.
>
> (B) In order for a public utility to be eligible to make an election to opt into an annual rate review, the public utility must have engaged in a general rate case pursuant to § 65-5-101 and subsection (a) within the last five (5) years; provided, however, that the authority may waive such requirement or increase the eligibility period upon a finding that doing such would be in the public interest.

(C) Pursuant to the procedures set forth in subdivision (d)(1), the authority shall review the annual filing by the public utility within one hundred twenty (120) days of receipt and order the public utility to make the adjustments to its tariff rates to provide that the public utility earns the authorized return on equity established in the public utility's most recent general rate case pursuant to§ 65-5-101 and subsection (a).

(D)(i) A public utility may terminate an approved annual review plan only by filing a general rate case pursuant to § 65-5-101 and subsection (a).

(ii) The authority may terminate an approved annual review plan only after citing the public utility to appear and show cause why the authority should not take such action pursuant to the procedures in § 65-2-106.

(iii) The authority or the public utility may propose a modification to the approved annual review plan for consideration by the authority. The authority 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 authority denies a modification to the approved annual review plan, the authority shall set forth with specificity the reasons for its denial.

The Authority must determine whether a proposed annual review mechanism before it meets the statutory requirements, including whether a mechanism is in public interest. The panel found that the *Settlement Agreement* contains several modifications to the ARM tariff Atmos originally proposed, including a true-up mechanism to reconcile the Company's budgets with actual results. The panel found that with the true-up mechanism in place to reconcile the Company's budgets and projections with actual results, Atmos will be able to recover its reasonably and prudently incurred expenses and costs of capital investment each year, allowing the Company to maintain its authorized return on equity through the agreed upon annual rate and reconciliation filings, without the filing of formal rate cases. The panel found that, as revised, the ARM tariff meets the requirements and fulfills the purpose of Tenn. Code §65-5-103(d)(6) and is in the public interest.

In addition, the panel found that, in accepting the *Settlement Agreement*, the Authority maintains the authority to review the reasonableness and prudency of the Company's expenses and capital investments included in the annual rate and reconciliation filings and make adjustments as required by the public interest and directed the Authority staff to perform such

reviews.[32] 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.[33] Therefore, the *Settlement Agreement* and the ARM tariff are consistent with the statute's intent to make reasonable annual tariff rate adjustments necessary to provide that the Company earns the authorized return on equity established by this Authority. Based on the foregoing findings and conclusions, the panel voted unanimously to approve the *Settlement Agreement*, including all attachments thereto, and the revised original tariff sheet 34.5 submitted on May 1, 2015.

IT IS THEREFORE ORDERED THAT:

1. The *Stipulation and Settlement Agreement*, including all attachments thereto, a copy of which is attached to this Order as Exhibit A, and the revised tariff sheet 34.5 submitted on May 1, 2015, attached as Exhibit B, is approved, adopted and incorporated into this Order.

2. The settlement of any issue pursuant to the *Stipulation and Settlement Agreement* shall not be cited by Atmos Energy Corporation, the Consumer Advocate and Protection Division of the Office of the Attorney General or any other entity as binding precedent in any other proceeding before the Authority or any court, state or federal.

Vice Chairman David F. Jones, Director Kenneth C. Hill and Director Robin Bennett concur.

ATTEST:

Earl R. Taylor, Executive Director

[32] Transcript of Hearing, p. 16 (May 11, 2015).
[33] *Joint Response to TRA First Data Request to Atmos Energy Corporation and Consumer Advocate and Protection Division of the Office of the Attorney General*, p. 5 (May 1, 2015).

BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

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

STIPULATION AND SETTLEMENT AGREEMENT

For the purpose of settling this case, Tennessee Regulatory Authority ("TRA" or "Authority") Docket No. 14-00146, Herbert H. Slatery III, the Tennessee Attorney General and Reporter, by and through the Consumer Advocate and Protection Division ("Consumer Advocate" or "CAPD") and Atmos Energy Corporation ("Atmos Energy" or "Company") respectfully submit this Stipulation and Settlement Agreement ("Settlement Agreement"). Subject to Authority approval, the Consumer Advocate and Atmos Energy (individually, a "Party" and, collectively, the "Parties") agree to the following:

BACKGROUND

1. Atmos Energy is incorporated under the laws of the State of Texas and the Commonwealth of Virginia and is engaged in the business of transporting, distributing and selling natural gas in Bedford, Blount, Carter, Greene, Hamblen, Maury, Moore, Obion, Rutherford, Sullivan and Williamson Counties within the State of Tennessee, with its principal Tennessee office and place of business located at 810 Crescent Centre Drive, Suite 600, Franklin, Tennessee 37067-6226.

2. The Tennessee public utility operations of Atmos Energy are subject to the jurisdiction of the TRA, pursuant to Chapter 4 of Tile 65 of the Tennessee Code Annotated.

3. On November 25, 2014, Atmos Energy filed a Petition of Atmos Energy Corporation for a General Rate Case and Petition to Adopt Annual Review Mechanism and ARM Tariff ("Petition") in this TRA Docket. In the first part of the Petition, Atmos Energy claimed a revenue deficiency, sought an increase in its annual revenues of approximately $5.89 million, and sought adoption of methodologies that would enable it to opt into an annual review of rates under Tenn. Code Ann. § 65-5-103(d)(6) (referred to as part one in the Petition and herein as the "Rate Case"). In the second part of the Petition, Atmos Energy sought approval of an Annual Review Mechanism ("ARM") and ARM tariff.

4. On December 23, 2014, the Consumer Advocate filed a Petition to Intervene. By order dated January 7, 2015, intervention was granted.

5. The Parties to this Settlement Agreement have engaged in substantial discovery. The Company also has provided information informally in response to questions from the Consumer Advocate and its witnesses, and has responded to additional discovery requests from TRA Staff.

6. The Consumer Advocate filed direct testimony on April 7, 2015, challenging several aspects of the Company's proposed rate increase and ARM proposal. Among the aspects challenged, as shown in the testimony of the CAPD witnesses filed in this Docket, were the Company's calculation of rate base and numerous expenses, as well as the methodologies by which the Company arrived at certain of the amounts requested. The Consumer Advocate's witnesses, after extensive discovery and analysis recommended a decrease in rates of approximately $3 million.

7. The Parties have undertaken extensive discussions and "give and take" negotiations to resolve all known disputed issues in this case. As a result of the information obtained during discovery and the discussions between the Parties, and for the purpose of avoiding further litigation and resolving this proceeding upon acceptable terms, the Parties have reached this Settlement Agreement.

In furtherance of this Settlement Agreement, the Parties have agreed to the settlement terms set forth below.

SETTLEMENT

8. Based upon the exchange of information and discussions described above, and in order to resolve this case through settlement and avoid the need for further litigation and expenses for all Parties, the Parties have agreed, subject to Authority approval, to certain adjustments and amendments to the Company's Petition, which are discussed herein.

9. **Attrition Period:** The Parties agree that the appropriate attrition period for use in the Rate Case part of this proceeding is the 12 months ended May 31, 2016.

10. **Revenue Deficiency:** The adjustments and amendments to the Company's requests filed in the Rate Case part of the Petition collectively reduce the Company's attrition period revenue deficiency from $5.89 million (a proposed revenue increase of 3.9%) to $0.71 million (an increase of 0.5%). The Parties agree that, subject to Authority approval, this revenue deficiency is reasonable and appropriate with respect to the Rate Case.

11. **Revenue Requirement:** The Parties agree, with respect to the Rate Case, that the Company's attrition period cost of service should include the components set forth on Attachment A hereto, which the Parties agree are fair and reasonable to the Company and its customers and which include the following:

a. Required operating income of $19,167,175;

b. A rate base of $247,923,553;

c. An overall rate of return of 7.73% on rate base;

d. A return on common equity of 9.80%;

e. A capital structure consisting of 5.01% short-term debt, 41.86% long-term debt, and 53.13% equity;

f. A cost of short-term debt of 1.07%;

g. A cost of long term debt of 5.90%; and

h. An attrition period revenue deficiency of $711,472.

12. **Rates:** The Parties agree that, with respect to the Rate Case, the rates reflected in Attachment A and tariffs reflected in Attachment B are fair and reasonable and appropriate for the limited purpose of resolving this proceeding. The Parties further agree that, subject to TRA approval, the Rate Case rates set forth on Attachment B shall be effective on bills rendered on and after June 1, 2015.

13. **Annual Review Mechanism and Ratemaking Methodologies:** The Parties agree (I) that the Company may opt into an annual review of its rates pursuant to Tenn. Code Ann. § 65-5-103(d)(6); (II) that the terms and conditions of the amended ARM tariff (which is attached hereto as Attachment C and referred to herein as the "ARM Tariff") are fair and reasonable and appropriate for the limited purpose of resolving this proceeding; and (III) as follows:

a. **Annual ARM Filing and Forward Looking Rate Adjustment**

(i) The Company shall make an annual revenue requirement filing on or before February 1 of each year ("Annual ARM Filing") under Tenn. Code Ann. § 65-5-103(d)(6)(A) and (C).

(ii) Certain required procedures, definitions, filings, and time frames relevant to the Annual ARM Filing are stated in the ARM Tariff.

(iii) The Company shall provide, with each year's Annual ARM Filing, each and every document, spreadsheet, workpaper, and exhibits and attachments that are listed or described on Attachment E. Nothing herein shall limit the TRA staff or Consumer Advocate from requesting additional data and/or documents after each Annual ARM Filing, and the Company shall provide any such additional requested data and/or document within 10 business days of such request.

(iv) All of the items listed or described on Attachment E shall be provided at the time that the Company makes the Annual ARM Filing. The Company will not make its first Annual ARM Filing prior to February 1, 2016.

(v) Each Annual ARM Filing shall present financial data and ratemaking calculations for a Historic Base Period and Forward Looking Test Year as defined and calculated in the ARM Tariff and shall calculate a revenue sufficiency or deficiency for the Forward Looking Test Year.

(vi) In each Annual ARM Filing, the Company shall utilize the Approved Methodologies, as defined below.

(vii) Any rate adjustment resulting from an Annual ARM Filing, after review, consideration, and adjustment of the tariff rates requested

by such Annual ARM Filing by the Authority under Tenn. Code Ann. § 65-5-103(d)(6)(C), shall be effective on bills rendered on and after June 1.

(viii) The resulting revenue sufficiency or deficiency for the Forward Looking Test Year shall be applied to all rate classes, excluding existing TRA approved Special Contracts (as defined in and set out on Attachment G to this Settlement Agreement).

(ix) The Parties further agree to an annual reconciliation of actual results to the Authorized Return on Equity, as more fully described as an Annual Reconciliation below.

b. **Representations and Warranties Made With Annual ARM Filing**

With each Annual ARM Filing, a Company officer shall, as of the date of each Annual ARM Filing, affirmatively represent and warrant, upon information and belief formed after reasonable inquiry, by signing a certificate ("Certificate") under oath:

(i) That the Company's Annual ARM Filing has been prepared in accordance with the Approved Methodologies, or that any deviation from or the resolution of any ambiguities in the Approved Methodologies has been affirmatively disclosed and explained in a document attached to such affidavit;

(ii) That all New Matters (as defined below) have been affirmatively disclosed and explained in a document attached to such affidavit;

(iii) That the Variance Report (as defined below) includes all matters that are required by this Settlement Agreement and any related Authority order to be disclosed in the Variance Report;

(iv) That no Disallowed Items (as identified and described in Attachment H to this Settlement Agreement) have been included in the Company's Annual ARM Filing;

(v) That, except as expressly disclosed in a separate schedule dedicated to such disclosure attached to the Certificate, there have been no additions, deletions, or modifications to the accounts or subaccounts used by the Company to account for operating revenues and expenses on the Effective Date (as defined below) of this Settlement Agreement and as such accounts or subaccounts have been provided to the Authority and Consumer Advocate in the form of discovery and data requests in this TRA Docket 14-00146, with such accounts forming the basis for the calculations and review performed in connection with and that resulted in this Settlement Agreement;

(vi) That there has been no change in the method of accounting or estimation in any account or subaccount referenced and described in the immediately preceding subsection (v) since the Effective Date of this Settlement Agreement;

c. **Allocation of Rate Change, If Any, After Annual ARM Filing, Among Customer Classes and Rate Components**

(i) The Forward Looking Test Year sufficiency or deficiency shall be distributed among the rate classes proportionate to the current margin of each class, proportionate to the current base and volumetric components within each class and otherwise consistent with the distribution methodology as reflected on Schedule 11-3 of this Settlement Agreement.

(ii) Existing Special Contracts are unaffected and will not see a change in rates.

d. **Special Contracts:** The Company will notify the Authority and Consumer Advocate at least 120 days prior to any termination, renewal, or other rate related change to any existing Special Contract and seek Authority approval for any such change. The Consumer Advocate may seek intervention in any such docket and Atmos Energy agrees not to object to the Consumer Advocate's intervention.

e. **Definitions**

(i) **Annual Filing Date** shall be the date the Company will make its Annual ARM Filing. The Annual Filing Date shall be no later than February 1 of each year.

(ii) **Historic Base Period** is defined as the twelve month period ending September 30 of each year prior to each Annual Filing Date.

(iii) **Forward Looking Test Year** is defined as the twelve months beginning June 1 of each calendar year.

(iv) **New Matters** refers to any issue, adjustment, and/or ambiguity in or for any account, method of accounting or estimation, or ratemaking topic that would directly or indirectly affect the Annual ARM Filing for which there is no explicit prior determination in this Docket 14-00146 by the Authority regarding the Company. The definition of "New Matters" includes, without limitation, any matter or item specifically described or set forth as a New Matter in this Settlement Agreement.

f. **Authorized Return on Equity:** The Parties stipulate and agree to an Authorized Return on Equity of 9.80% for the Rate Case portion of this Docket, which shall therefore be used in calculating the revenue sufficiency or deficiency under the ARM Tariff.

g. **Methodologies for Calculation of Annual Revenue Requirement and Resulting Sufficiency or Deficiency for each Forward Looking Test Year.** The revenue requirement and resulting sufficiency or deficiency shall be calculated using the ratemaking methodologies explicitly defined and set out in this Settlement Agreement ("Approved Methodologies").

(i) **Billing Determinants and Revenue at Present Rates**

A. **Forward Looking Test Year Billing Determinants** – In calculating Settlement Forward Looking Test Year Billing Determinants, the Company shall begin with Historic Base Period sales and transportation volumes, bills and billing demand units. The Company shall then adjust the billing determinants for normal

weather, annualized customer usage and customer growth to arrive at Forward Looking Test Year Billing Determinants. The weather adjustment shall be calculated using the weather data from the Bristol, Knoxville, Nashville and Paducah weather stations to normalize sales data, and the Company shall use the daily normal weather for the 30-year period ending at the end of each Historic Base Period. For industrial and transportation customers the Company shall analyze the sales volumes of the Company's largest customers and adjust volumes accordingly based on any known and measurable changes expected for each Forward Looking Test Year. For residential and commercial customers the Company shall use a two year average, with the last year being the Historic Base Period, to calculate customer growth adjustments. The customer change shall then be multiplied by annualized normal usage per customer to arrive at the adjustment to volumes consistent with the applicable tariffs, rules and regulations.

B. **Forward Looking Test Year Revenues** – Forward Looking Test Year Revenues shall be calculated by multiplying the Forward Looking Test Year Billing Determinants by the rates effective at the end of the Historic Base Period consistent with Schedule 11-2 to this Settlement Agreement.

C. **Weather Normalization** – The weather adjustment shall be calculated using the weather data from the Bristol, Nashville,

Knoxville (TN) and Paducah (KY) NOAA weather stations to normalize actual usage for all customers served under Rate Schedule (210), (211), (220), (221) and (225), as well as the commercial sales customers under Rate Schedule (230). From this data a 30–year daily normal ending at the conclusion of the Historic Base Period shall be calculated. Monthly normal cycle degree days shall be calculated from the 16th of the previous month to the 15th of the current month to approximate cycle-billing. Weather normalization months shall be the periods from October through April. Normalized HDDs by weather station for the Historic Base Period ending June 30, 2014 are attached as Attachment D to this Settlement Agreement. Beginning with the Company's initial Annual ARM Filing on February 1, 2016, the normalized HDDs will be presented as of the end of each Historic Base Period ending September 30th of each year. Weather normalization shall continue to be subject to annual TRA audit and the Consumer Advocate shall have the right to intervene in any docket related to the audit. Atmos Energy agrees not to object to any such intervention by the Consumer Advocate.

D. **Other Revenues** – The Company shall calculate Other Revenues, consisting primarily of forfeited discounts and miscellaneous service charges, by calculating a two year average of these amounts up to the end of each Historic Base Period.

E. **Cost of Gas** -- The Company shall calculate Cost of Gas by using the Historic Base Period per books cost of gas adjusted to remove rent for Intercompany Leased Storage Property to arrive at the Forward Looking Test Year Cost of Gas.

h. **Operations and Maintenance Expense ("O&M").** Total O&M excluding Cost of Gas shall be comprised of expenses incurred directly in the Company's Tennessee operations and expenses allocated from the three rate divisions that allocate expenses to Tennessee (Division 091, the Kentucky Mid-States General Office; Division 002, Shared Services General Office; and Division 012, Shared Services Customer Service). The forecast for O&M shall be developed independently for each of the four rate divisions using the forecast methodologies defined below. For divisions 091, 002 and 012, the amount of expense shall be allocated to the Tennessee operation as described in the Company's Cost Allocation Manual (CAM).

(i) **Labor** – Labor expense shall be equal to the Company's most recently completed and approved budget for the months of the Forward Looking Test Year for which the budget is available. Labor expense shall be forecasted using an inflation factor to adjust the months of the Forward Looking Test Year that extend beyond the Company's most recently completed budget. The inflation factor shall be the Company's budgeted average target common merit increase from its most recently completed budget.

The development of the O&M forecast shall be consistent for each entity that allocates costs to Tennessee. For divisions 091, 002 and 012, the appropriate amount of expense shall be allocated to the Tennessee operation as described in the Company's Cost Allocation Manual (CAM).

(ii) **Non-Labor (excluding rent, FAS 87 accrual, disallowances and bad debt expenses)** -- Non-labor O&M expense types other than otherwise noted above and below shall be equal to the Company's most recently completed budget for the months of the Forward Looking Test Year for which the budget is available. Non-labor expense types other than otherwise noted below are forecasted using a standard inflation factor to adjust the months of the Forward Looking Test Year that extend beyond the Company's most recently completed budget. The inflation factor used is the average inflation rate for the southern region over the previous two years as reported by the U.S. Department of Labor. The development of the O&M forecast shall be consistent for each entity that allocates costs to Tennessee. For divisions 091, 002 and 012, the appropriate amount of expense shall be allocated to the Tennessee operation as described in the Company's Cost Allocation Manual (CAM).

(iii) **Rent** – The Company shall use a 0% inflation factor for lease payments (subaccounts 05481 and 05480). For the Forward

Looking Test Year ending May 31, 2016 used in this Docket, the Company shall include in its O&M forecast the adjustments documented and described in the response to CAPD DR 1-58 (removal of the Franklin building from the plant additions forecast and addition of lease payments previously removed) (attached as Attachment I).

(iv) **FAS 87 accrual** – The Company shall remove from O&M any amounts related to FAS 87 expenses (subaccount 01202, and any amount in any successor or replacement account or subaccount containing FAS 87 expenses). In years that the Company makes actual cash contributions to its pension fund, it shall be allowed to recover those cash contributions as part of the annual reconciliation process described below. The amount of cash contribution allocable to and recoverable from Tennessee shall be consistent with the methodology represented in WP 4-4 of this Settlement Agreement and be based on the amount of future liability allocable to Tennessee as defined by the Company's actuary. The allocation methodology described is consistent with that used in Docket Nos. 08-00197 and 12-00064.

(v) **Disallowances** – The Company shall remove from O&M amounts related to incentive compensation, spousal and dependent travel, and non-deductible dues. Specifically, the Company shall remove allocated net expense amounts for incentive compensation, spousal

and dependent travel, and non-deductible dues budgeted in the following subaccounts: 07452, 07458, 07460, 07463, 07454, 07450, 05416, and 05412, as well as any subaccount that in form or substance could constitute a successor or replacement for such subaccount.

(vi) **Bad Debt Expense** – The Company shall calculate and include in O&M 0.5% of expected residential, commercial and public authority gross margins as calculated on WP 4-3 of this Settlement Agreement.

(vii) **Rate Case Expense** – The Company shall include an annual amount of $175,000 in the Forward Looking Test Year O&M to account for a 3 year amortization of the estimated rate case expenses for this Docket. Upon completion of this Docket, the Company shall defer accumulated rate case expenses and begin amortizing the actual balance at $14,583.33 per month until the actual balance is fully amortized. In the Forward Looking Test Year following the full amortization of the rate case expense balance, the Company shall cease to include in O&M an adjustment for rate case expense. The Company shall include in its normal operating budget an estimated amount for legal expenses as it would any other O&M expense. Legal expenses associated with prosecuting the Company's Annual ARM Filing are expected to be annually recurring and significantly lower than

the level required to prosecute a traditional rate case. The annual expense incurred for such legal expenses shall be subject to the annual reconciliation described below just like any other O&M expense.

(viii) **Other** - An adjustment for intercompany leased property shall be included consistent with the data and calculations on WP 3-1 attached to this Settlement Agreement and all previous rate filings made by the Company since 1989.

i. **Taxes, Other than Income Taxes**

(i) Total Taxes, Other than Income Taxes shall be comprised of taxes incurred directly in the Company's Tennessee operations and taxes allocated from the three rate divisions that allocate expenses to Tennessee (Division 091, the Kentucky Mid-States General Office; Division 002, Shared Services General Office; and Division 012, Shared Services Customer Service). The forecast for Taxes, Other than Income Taxes shall be developed independently for each of the four rate divisions. For divisions 091, 002 and 012, the appropriate amount of taxes shall be allocated to the Tennessee operation as described in the Company's Cost Allocation Manual (CAM). The forecast for Taxes, Other Than Income Taxes shall be comprised of the Company's most recently completed budget for each type of tax with the following two exceptions:

A. Payroll taxes (FICA, FUTA, SUTA) shall be inflated at the same rate as labor O&M for months in the Forward Looking Test Year that extend beyond the most recently completed budget; and

B. The monthly accrual for ad valorem taxes shall be the Company's most recent monthly accrual for estimated ad valorem taxes due.

(ii) An adjustment for intercompany leased property shall be included consistent with the data and calculations on WP 3-1 attached to this Settlement Agreement and all previous rate filings made by the Company since 1989.

j. **Depreciation and Amortization Expense**

(i) Depreciation and Amortization Expense for each Forward Looking Test Year shall be calculated within the Company's plant forecast described below. Depreciation expense shall be calculated by multiplying the approved rate for each account by the projected account balance for each month. The depreciation rates used to calculate depreciation expense are those most recently approved by the Authority for Tennessee and each of the entities allocable to Tennessee. Depreciation expense allocable to Tennessee shall be done in accordance with the Company's Cost Allocation Manual (CAM).

(ii) For the attrition years ending May 31, 2016 and May 31, 2017, the Company shall include in Amortization Expense $649,245 each

year to account for a 2-year amortization of the regulatory asset related to FAS 87 which it was authorized to establish in the Order from Docket No. 12-00064. The regulatory asset will be fully amortized on May 31, 2017.

(iii) Prudent rate making and accounting requires that depreciation rates be updated periodically. The Company's practice is to conduct depreciation studies and update rates in its various operating divisions and entities housing shared assets (including the Kentucky Mid-States General Office and SSU) every 4-6 years. The Company does plan to conduct depreciation studies in the future consistent with this practice and prudent accounting and rate making procedures. In the event it conducts a depreciation study for its Tennessee operations or any of the entities that house shared assets that support Tennessee operations, the Company shall, within 30 days of completing the study, file the depreciation study with the TRA, and provide a copy to the Consumer Advocate, and ask that the rates contained in the study be approved for its next annual review. Following any appropriate discovery and rebuttal, and conditioned upon approval by the TRA of new rates, the Company shall calculate depreciation expense using the newly approved rates in its subsequent Annual ARM Filing. To assist with review, the Company shall file any new depreciation study

when it is completed, rather than waiting until it makes the next Annual ARM Filing.

(iv) An adjustment for intercompany leased property shall be included consistent with the data and calculations on WP 3-1 attached to this Settlement Agreement and all previous rate filings made by the Company since 1989.

k. **Rate Base** The rate base shall include projected thirteen month averages for each of the following components. Each component shall be forecasted consistent with the methodologies described in each section below:

(i) **Original Cost of Plant** – The forecast of monthly gross plant balances shall begin with the actual plant balances at the end of the Historic Base Period. Plant additions for the period between the end of the Historic Base Period and end of the Forward Looking Test Year are made up of projected and budgeted plant additions from the Company's monthly projections and most recently completed capital budget. Plant additions are comprised of three components:

(A) the capital spending for Tennessee;

(B) the amount allocated to Tennessee resulting from capital spending by the KY/Mid-States Division's general office; and

(C) the amount allocated to Tennessee resulting from capital spending by the Company's Shared Services (SSU) during the Forward Looking Test Year.

Two components of SSU that house shared plant assets, the Charles K. Vaughan Center (CKV) and Greenville data center, shall use allocation percentages that recognize the unique nature and use of those assets and that are consistent with the Company's workpapers. The capital forecast shall be converted to plant account ("300 account") detail for the purpose of projecting additions, retirements, depreciation expense, accumulated depreciation and resulting net plant at the required level of detail. Projected plant retirements shall be based on the level of retirements recorded during each Historic Base Period. For the initial Forward Looking Test Year ending May 31, 2016, the Company shall include in its rate base forecast the adjustments documented and described in the response to CAPD DR 1-58 (removal of the Franklin building from the plant additions forecast and addition of lease payments previously removed), attached as Attachment I.

(ii) **Accumulated Depreciation and Amortization** – Accumulated depreciation and amortization for each Forward Looking Test Year shall be forecast within the Company's plant projection described in the preceding section and shall incorporate the most recently

approved depreciation rates. The forecast shall begin with actual per books accumulated depreciation balances at the end of the Historic Base Period. For each month between the end of each Historic Base Period and the end of each Forward Looking Test Year, the forecast shall add projected depreciation expense and deduct the same retirements that were projected for gross plant. Depreciation expense shall be calculated by multiplying the approved rate for each account by the projected account balance for each month.

(iii) **Construction Work in Progress ("CWIP")** – The balance of CWIP at the end of each Historic Base Period shall be projected to remain constant through the end of each Forward Looking Test Year as capital spending is offset by completing projects and placing assets in service.

(iv) **Storage Gas Investment** - Forward Looking Test Year storage gas balances shall be based on actual balances through the end of each Historic Base Period and forecasted storage usage with future injections priced at NYMEX futures prices.

(v) **Cash Working Capital** - The Company conducted a new lead-lag study for this Docket in order to calculate cash working capital requirements. Rather than conduct a new lead-lag study with each Annual ARM Filing, the Company shall apply the lead-lag factors from this study to the subsequent annual Forward Looking Test

Year cost of service items and revenues in order to calculate cash working capital requirements each Forward Looking Test Year.

(vi) **Materials and Supplies** - The balance of materials and supplies at the end of each Historic Base Period shall be projected to remain constant through the end of each Forward Looking Test Year.

(vii) **Regulatory Assets** - Attachment F lists the regulatory assets that are recognized for the Company. Attachment F shall include the Deferred Pension Regulatory Asset that is more particularly described below.

(viii) **Deferred Pension Regulatory Asset Balance** - The Company shall include in rate base the average unamortized portion of the regulatory asset related to FAS 87 which it was authorized to establish in the Final Order from Docket No. 12-00064. The regulatory asset will be fully amortized on May 31, 2017. No further regulatory asset for FAS 87 shall be established unless so established by the TRA, and until the TRA adopts new ratemaking methodologies thereto.

(ix) **Accumulated Deferred Income Tax** – Accumulated Deferred Income Taxes ("ADIT") shall be forecasted consistent with this Settlement Agreement and shall be based on forecasted plant additions and currently enacted tax law. The forecast of monthly ADIT balances shall begin with the actual ADIT balances at the end of the Historic Base Period. The forecast of book plant

additions and book depreciation for the period between the end of the Historic Base Period and end of the Forward Looking Test Year shall be consistent with the amounts described above in (k)(i) and (k)(ii). To arrive at tax plant additions, the tax repairs basis adjustment shall be estimated based on the type of projected book plant additions and prior period deductible percentages. In periods for which bonus depreciation has been enacted, the bonus depreciation basis adjustment shall be estimated based on the type of projected book plant additions, using the last known bonus depreciation percentages, by rate division. Projected tax plant additions shall be used to compute tax projected depreciation in accordance with the current MACRs rates. The difference between projected book plant additions and projected tax plant additions results in projected fixed asset cost ADIT. The difference between projected book accumulated depreciation and projected tax accumulated depreciation results in projected fixed asset accumulated ADIT. All other ADIT balances shall be held constant from the end of the Historic Base Period: only fixed asset cost and accumulated ADIT are projected. ADIT balances for Tennessee and each rate division allocable to Tennessee shall include both liability and asset balances including NOLCs. ADIT shall include a ratemaking adjustment consistent with the

B. Actual long term debt ("LTD") balance at the end of each Historic Base Period

C. Twelve-month average short term debt ("STD") balance for the 12 months that comprise each Historic Base Period

(ii) **Cost of Debt** - Cost of Long Term Debt shall be calculated annually as it is calculated on WP 9-3 of this Settlement Agreement. Cost of Short Term Debt shall be calculated annually as it is calculated on WP 9-2 of this Settlement Agreement.

(iii) **Return on Equity** – The Authorized Return on Equity shall be 9.80% until a different return on equity is adopted by the Authority in a subsequent general rate case.

m. **Other Methodologies Adopted --** To the extent that ratemaking methodologies are not described in this Settlement Agreement and are not inconsistent with any methodology 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; provided, however, that to the extent that any such methodology is or could be interpreted as ambiguous or contradictory, no methodology shall be inferred with respect to the item or process that is ambiguous or contradictory.

14. **Annual Reconciliation of Actual Results to Authorized Return on Equity**

a. On or before September 1 of each year, the Company shall file with the Authority, and shall provide a copy to the Consumer Advocate, a reconciliation of actual results ("Annual Reconciliation") to the Authorized Return on Equity for the Forward Looking Test Year immediately completed.

b. 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. Actual cost of service shall be compared with actual booked revenue, ignoring the revenue impact of any prior year reconciliation, to determine the revenue requirement ("Annual Reconciliation Revenue Requirement") necessary to adjust the actual return on equity to the Authorized Return on Equity for the Forward Looking Test Year immediately completed, all determined in accordance with the Approved Methodologies. The calculation of the Annual Reconciliation Revenue Requirement shall be consistent with Schedule 12 of the ARM Tariff (Attachment C). Interest will be added to the Annual Revenue Reconciliation Revenue Requirement (whether positive or negative). The interest rate shall be the Overall Cost of Capital as stated on Schedule 9 of the Annual ARM Filing Compounded for 2 years.

c. New rates shall be calculated to produce a net rate adjustment comprised of the Annual Reconciliation Revenue Requirement from the most recently completed Forward Looking Test Year and the revenue sufficiency/deficiency for the ensuing Forward Looking Test Year, all determined in accordance with the methodologies set forth herein and as approved and adopted by the Authority.

d. The resulting rates shall be effective on bills rendered on and after June 1 of each year. All tariff rates (except Special Contract rates, which shall not be affected) shall be adjusted in proportion to the relative base revenue share of each class as described above.

e. The first Annual Reconciliation Revenue Requirement filing shall occur on September 1, 2016, and shall cover the Forward Looking Test Year ended May 31, 2016. The resulting Annual Reconciliation Revenue Requirement shall be incorporated into the Company's February 1, 2017 Annual ARM Filing.

15. **Variance Report and ARM Review --** As part of its Annual ARM Filing, Atmos Energy shall prepare and file with the TRA, with a copy to the Consumer Advocate, a Variance Report ("Variance Report") that identifies and explains each and every Atmos Energy operating revenue and expense account and/or subaccount for which the Tennessee amount (including amounts allocated to Tennessee) either:

a. exceeds the prior year's amount (based on amounts either as filed by Atmos Energy in the Annual ARM Filing or as adjusted by the TRA under Tenn. Code Ann. § 65-5-103(d)(6)(C)) by 5% and $30,000; or

b. exceeds the amount (based on amounts either as filed by Atmos Energy in the Annual ARM Filing or as adjusted by the TRA under Tenn. Code Ann. § 65-5-103(d)(6)(C)) in such account and/or subaccount in the third preceding year by 10% and $60,000; or

c. has been, when compared with the accounts and/or subaccounts existing on the Effective Date of this Settlement Agreement and/or used in the calculations referenced herein, added or deleted or modified in form or substance in any way.

As to any account and/or subaccount (and including without limitation any process related directly or indirectly to any such account or subaccount) included on a Variance Report, the TRA and/ or Consumer Advocate shall have the right in its discretion to request additional information and an explanation from Atmos Energy. Atmos Energy agrees to provide any such information or explanation requested within ten business days of such request. The Consumer Advocate, further, has the right in its discretion to bring such account and/or subaccount (or related process) to the attention of the Authority and to request the Authority to review and consider such account and/or subaccount (or related process). Without limiting the Authority's discretion, the Consumer Advocate may recommend any form or process of review it deems appropriate, including without limitation a review that would include the appointment of a third party to review and report on the account and/or subaccount (or related process).

16. **CAPD Authority to Petition** -- The CAPD shall have the right in its sole discretion to file a petition or complaint asking the TRA to terminate or modify any ARM Tariff resulting from this Docket or any directly or indirectly related docket or to take any other action contemplated by Tenn. Code Ann. § 65-5-103(d)(6). Atmos Energy agrees not to oppose the

CAPD's petition or complaint filed under this Section on the grounds that such a proceeding is not statutorily authorized or that CAPD is not authorized to bring such a proceeding; provided, however, that Atmos Energy reserves all rights with regard to the merits of any termination or modification or other relief that the CAPD may request or position that the CAPD may assert in any such proceeding.

17. The Parties agree that the terms of this Settlement Agreement are fair and reasonable to all customer classes and will provide Atmos Energy with a reasonable opportunity to recover the agreed upon operating revenue requirement and a reasonable rate of return on investment.

18. The Parties agree to support this Settlement Agreement before the Authority and in any hearing, proposed order, or brief conducted or filed in this proceeding.

19. The Parties acknowledge that Atmos Energy brought this matter, *inter alia*, to determine rates in a general rate case and to establish adopted ratemaking methodologies sufficient to enable implementation of the annual review mechanism established by Tenn. Code Ann. § 65-5-103(d)(6). The Parties jointly request that the Authority adopt the ratemaking methodologies set forth in this Settlement Agreement for the limited purpose of implementing an annual review mechanism under Tenn. Code Ann. § 65-5-103(d)(6) under this Docket, and approve the annual review mechanism and ARM Tariff consistent with the terms and requirements established by this Settlement Agreement. The methodologies adopted by the Authority as a result of the above request shall be utilized in preparing and evaluating each Annual ARM Filing and Annual Reconciliation filing contemplated under this Docket.

20. None of the Parties waives its right to take other positions with respect to matters similar to those settled herein in future proceedings before the Authority.

21. The resolution of issues reflected herein is the result of give and take negotiations between the Parties and does not necessarily reflect the position of any single Party on any discrete issue, and no Party waives the right to assert any position in any future proceeding.

22. Except to the limited extent necessary to allow the Authority to implement an annual review mechanism under Tenn. Code Ann. § 65-5-103(d)(6) in this Docket (and, for the avoidance of doubt, only in this Docket 14-00146), the Parties acknowledge and agree as follows:

a. This Settlement Agreement shall not have any precedential effect in any other proceeding or be binding upon any of the Parties in this or any other jurisdiction;

b. None of the signatories hereto shall be deemed to have acquiesced in any ratemaking or procedural principle, including without limitation, any cost of service determination or cost allocation or revenue related methodology,

c. No provision of this Settlement Agreement shall be deemed an admission of any Party.

23. The Parties agree that all pre-filed testimony and exhibits and attachments of the Parties (including pre-filed supplemental testimony and exhibits and attachments supporting this Settlement Agreement) will be admitted into evidence without objection and become part of the public record and the Parties hereby waive their right to cross-examine all witnesses with respect to such pre-filed testimony and exhibits and attachments; provided, however, that should questions be asked of such witnesses by any person at the hearing of this matter (including any questions by Directors), the Parties may cross-examine any witness with respect to such

questions consistent with the agreement set forth in this Settlement Agreement. As to the Supplemental Testimony that is the subject of the Consumer Advocate's Motion for Leave to File Supplemental Testimony filed on April 21, 2015, and any rebuttal thereto, the parties shall abide by the hearing officer's decision. Public comment regarding the Settlement Agreement will also be welcome and encouraged by the Parties.

24. The terms of the Settlement Agreement have resulted from extensive negotiations between the signatories and the terms hereof are interdependent. The provisions of this Settlement Agreement are agreements reached in compromise and settlement and solely for the purpose of resolving this Docket without the need for further litigation.

25. The provisions of this Settlement Agreement are not severable.

26. The Parties jointly recommend that the Authority issue an order adopting this Settlement Agreement in its entirety without modification.

27. If the Authority does not approve the settlement in its entirety, the Parties are not bound by any position or term set forth in this Settlement Agreement, except for this Section. In the event that the Authority does not approve this Settlement Agreement in its entirety, each of the signatories to this Settlement Agreement will retain the right to terminate this Settlement Agreement and/or to seek additional time to consider or review any proposed modifications. By agreeing to this Settlement Agreement, no Party waives any right to continue litigating this matter should the Settlement Agreement be rejected or modified, in whole or in part, by the Authority.

28. The Parties agree that this Settlement Agreement constitutes the complete understanding among the Parties concerning the resolution of issues and matters under this TRA Docket 14-00146, and any oral statements, representations or agreement concerning such issues

and matters made prior to the execution of this Settlement Agreement have been merged into this Settlement Agreement.

29. The Consumer Advocate's agreement to this Settlement Agreement is expressly premised upon the truthfulness, accuracy and completeness of the information provided by the Company to the Consumer Advocate throughout the course of this Docket, which information was relied upon by the Consumer Advocate in negotiating and agreeing to the terms and conditions of this Settlement Agreement.

30. The acceptance of this Settlement Agreement by the Attorney General shall not be deemed approval by the Attorney General of any of the Company's practices.

31. Each signatory to this Settlement Agreement represents and warrants that it/he/she has informed, advised and otherwise consulted with the Party for whom it/he/she signs regarding the contents and significance of this Settlement Agreement and has obtained authority to sign on behalf of such Party, and based upon those communications, each signatory represents and warrants that it/he/she is authorized to execute this Settlement Agreement on behalf of its/his/her respecting Party.

32. This Settlement Agreement shall be governed by and construed under the laws of the State of Tennessee. Nothing herein limits or alters the Sovereign Immunity of the State of Tennessee or any of its entities or subdivisions.

33. The Parties agree that this Settlement Agreement may be executed in multiple counterparts and by copies provided by facsimile or in .pdf format.

34. The date set forth immediately following shall be the "Effective Date" for purposes of this Settlement Agreement.

The foregoing is agreed and stipulated to this 29th day of April, 2015.

STIPULATION AND SETTLEMENT AGREEMENT
IN TRA DOCKET 14-00146
SIGNATURE PAGE

ATMOS ENERGY CORPORATION

A. Scott Ross, #15634
Blind Akrawi, #23213
Neal & Harwell, PLC
2000 One Nashville Place
150 Fourth Avenue, North
Nashville, TN 37219-2498
(615) 244-1713 – Telephone

Dated: April 29th, 2015

STIPULATION AND SETTLEMENT AGREEMENT
IN TRA DOCKET 14-00146
SIGNATURE PAGE

CONSUMER ADVOCATE AND PROTECTION DIVISION

Herbert H. Slatery III, #09077
Attorney General and Reporter

Wayne M. Irvin, #30946
Assistant Attorney General
Office of the Attorney General
Consumer Advocate and Protection Division
P. O. Box 20207
Nashville, TN 37202-0207

Dated: April 29, 2015

BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

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

STIPULATION AND SETTLEMENT AGREEMENT

For the purpose of settling this case, Tennessee Regulatory Authority ("TRA" or "Authority") Docket No. 14-00146, Herbert H. Slatery III, the Tennessee Attorney General and Reporter, by and through the Consumer Advocate and Protection Division ("Consumer Advocate" or "CAPD") and Atmos Energy Corporation ("Atmos Energy" or "Company") respectfully submit this Stipulation and Settlement Agreement ("Settlement Agreement"). Subject to Authority approval, the Consumer Advocate and Atmos Energy (individually, a "Party" and, collectively, the "Parties") agree to the following:

BACKGROUND

1. Atmos Energy is incorporated under the laws of the State of Texas and the Commonwealth of Virginia and is engaged in the business of transporting, distributing and selling natural gas in Bedford, Blount, Carter, Greene, Hamblen, Maury, Moore, Obion, Rutherford, Sullivan and Williamson Counties within the State of Tennessee, with its principal Tennessee office and place of business located at 810 Crescent Centre Drive, Suite 600, Franklin, Tennessee 37067-6226.

2. The Tennessee public utility operations of Atmos Energy are subject to the jurisdiction of the TRA, pursuant to Chapter 4 of Tile 65 of the Tennessee Code Annotated.

3. On November 25, 2014, Atmos Energy filed a Petition of Atmos Energy Corporation for a General Rate Case and Petition to Adopt Annual Review Mechanism and ARM Tariff ("Petition") in this TRA Docket. In the first part of the Petition, Atmos Energy claimed a revenue deficiency, sought an increase in its annual revenues of approximately $5.89 million, and sought adoption of methodologies that would enable it to opt into an annual review of rates under Tenn. Code Ann. § 65-5-103(d)(6) (referred to as part one in the Petition and herein as the "Rate Case"). In the second part of the Petition, Atmos Energy sought approval of an Annual Review Mechanism ("ARM") and ARM tariff.

4. On December 23, 2014, the Consumer Advocate filed a Petition to Intervene. By order dated January 7, 2015, intervention was granted.

5. The Parties to this Settlement Agreement have engaged in substantial discovery. The Company also has provided information informally in response to questions from the Consumer Advocate and its witnesses, and has responded to additional discovery requests from TRA Staff.

6. The Consumer Advocate filed direct testimony on April 7, 2015, challenging several aspects of the Company's proposed rate increase and ARM proposal. Among the aspects challenged, as shown in the testimony of the CAPD witnesses filed in this Docket, were the Company's calculation of rate base and numerous expenses, as well as the methodologies by which the Company arrived at certain of the amounts requested. The Consumer Advocate's witnesses, after extensive discovery and analysis recommended a decrease in rates of approximately $3 million.

7. The Parties have undertaken extensive discussions and "give and take" negotiations to resolve all known disputed issues in this case. As a result of the information obtained during discovery and the discussions between the Parties, and for the purpose of avoiding further litigation and resolving this proceeding upon acceptable terms, the Parties have reached this Settlement Agreement.

In furtherance of this Settlement Agreement, the Parties have agreed to the settlement terms set forth below.

SETTLEMENT

8. Based upon the exchange of information and discussions described above, and in order to resolve this case through settlement and avoid the need for further litigation and expenses for all Parties, the Parties have agreed, subject to Authority approval, to certain adjustments and amendments to the Company's Petition, which are discussed herein.

9. **Attrition Period:** The Parties agree that the appropriate attrition period for use in the Rate Case part of this proceeding is the 12 months ended May 31, 2016.

10. **Revenue Deficiency:** The adjustments and amendments to the Company's requests filed in the Rate Case part of the Petition collectively reduce the Company's attrition period revenue deficiency from $5.89 million (a proposed revenue increase of 3.9%) to $0.71 million (an increase of 0.5%). The Parties agree that, subject to Authority approval, this revenue deficiency is reasonable and appropriate with respect to the Rate Case.

11. **Revenue Requirement:** The Parties agree, with respect to the Rate Case, that the Company's attrition period cost of service should include the components set forth on Attachment A hereto, which the Parties agree are fair and reasonable to the Company and its customers and which include the following:

a. Required operating income of $19,167,175;

b. A rate base of $247,923,553;

c. An overall rate of return of 7.73% on rate base;

d. A return on common equity of 9.80%;

e. A capital structure consisting of 5.01% short-term debt, 41.86% long-term debt, and 53.13% equity;

f. A cost of short-term debt of 1.07%;

g. A cost of long term debt of 5.90%; and

h. An attrition period revenue deficiency of $711,472.

12. **Rates:** The Parties agree that, with respect to the Rate Case, the rates reflected in Attachment A and tariffs reflected in Attachment B are fair and reasonable and appropriate for the limited purpose of resolving this proceeding. The Parties further agree that, subject to TRA approval, the Rate Case rates set forth on Attachment B shall be effective on bills rendered on and after June 1, 2015.

13. **Annual Review Mechanism and Ratemaking Methodologies:** The Parties agree (I) that the Company may opt into an annual review of its rates pursuant to Tenn. Code Ann. § 65-5-103(d)(6); (II) that the terms and conditions of the amended ARM tariff (which is attached hereto as Attachment C and referred to herein as the "ARM Tariff") are fair and reasonable and appropriate for the limited purpose of resolving this proceeding; and (III) as follows:

a. **Annual ARM Filing and Forward Looking Rate Adjustment**

(i) The Company shall make an annual revenue requirement filing on or before February 1 of each year ("Annual ARM Filing") under Tenn. Code Ann. § 65-5-103(d)(6)(A) and (C).

(ii) Certain required procedures, definitions, filings, and time frames relevant to the Annual ARM Filing are stated in the ARM Tariff.

(iii) The Company shall provide, with each year's Annual ARM Filing, each and every document, spreadsheet, workpaper, and exhibits and attachments that are listed or described on Attachment E. Nothing herein shall limit the TRA staff or Consumer Advocate from requesting additional data and/or documents after each Annual ARM Filing, and the Company shall provide any such additional requested data and/or document within 10 business days of such request.

(iv) All of the items listed or described on Attachment E shall be provided at the time that the Company makes the Annual ARM Filing. The Company will not make its first Annual ARM Filing prior to February 1, 2016.

(v) Each Annual ARM Filing shall present financial data and ratemaking calculations for a Historic Base Period and Forward Looking Test Year as defined and calculated in the ARM Tariff and shall calculate a revenue sufficiency or deficiency for the Forward Looking Test Year.

(vi) In each Annual ARM Filing, the Company shall utilize the Approved Methodologies, as defined below.

(vii) Any rate adjustment resulting from an Annual ARM Filing, after review, consideration, and adjustment of the tariff rates requested

by such Annual ARM Filing by the Authority under Tenn. Code Ann. § 65-5-103(d)(6)(C), shall be effective on bills rendered on and after June 1.

(viii) The resulting revenue sufficiency or deficiency for the Forward Looking Test Year shall be applied to all rate classes, excluding existing TRA approved Special Contracts (as defined in and set out on Attachment G to this Settlement Agreement).

(ix) The Parties further agree to an annual reconciliation of actual results to the Authorized Return on Equity, as more fully described as an Annual Reconciliation below.

b. **Representations and Warranties Made With Annual ARM Filing**

With each Annual ARM Filing, a Company officer shall, as of the date of each Annual ARM Filing, affirmatively represent and warrant, upon information and belief formed after reasonable inquiry, by signing a certificate ("Certificate") under oath:

(i) That the Company's Annual ARM Filing has been prepared in accordance with the Approved Methodologies, or that any deviation from or the resolution of any ambiguities in the Approved Methodologies has been affirmatively disclosed and explained in a document attached to such affidavit;

(ii) That all New Matters (as defined below) have been affirmatively disclosed and explained in a document attached to such affidavit;

(iii) That the Variance Report (as defined below) includes all matters that are required by this Settlement Agreement and any related Authority order to be disclosed in the Variance Report;

(iv) That no Disallowed Items (as identified and described in Attachment H to this Settlement Agreement) have been included in the Company's Annual ARM Filing;

(v) That, except as expressly disclosed in a separate schedule dedicated to such disclosure attached to the Certificate, there have been no additions, deletions, or modifications to the accounts or subaccounts used by the Company to account for operating revenues and expenses on the Effective Date (as defined below) of this Settlement Agreement and as such accounts or subaccounts have been provided to the Authority and Consumer Advocate in the form of discovery and data requests in this TRA Docket 14-00146, with such accounts forming the basis for the calculations and review performed in connection with and that resulted in this Settlement Agreement;

(vi) That there has been no change in the method of accounting or estimation in any account or subaccount referenced and described in the immediately preceding subsection (v) since the Effective Date of this Settlement Agreement;

c. **Allocation of Rate Change, If Any, After Annual ARM Filing, Among Customer Classes and Rate Components**

(i) The Forward Looking Test Year sufficiency or deficiency shall be distributed among the rate classes proportionate to the current margin of each class, proportionate to the current base and volumetric components within each class and otherwise consistent with the distribution methodology as reflected on Schedule 11-3 of this Settlement Agreement.

(ii) Existing Special Contracts are unaffected and will not see a change in rates.

d. **Special Contracts:** The Company will notify the Authority and Consumer Advocate at least 120 days prior to any termination, renewal, or other rate related change to any existing Special Contract and seek Authority approval for any such change. The Consumer Advocate may seek intervention in any such docket and Atmos Energy agrees not to object to the Consumer Advocate's intervention.

e. **Definitions**

(i) **Annual Filing Date** shall be the date the Company will make its Annual ARM Filing. The Annual Filing Date shall be no later than February 1 of each year.

(ii) **Historic Base Period** is defined as the twelve month period ending September 30 of each year prior to each Annual Filing Date.

(iii) **Forward Looking Test Year** is defined as the twelve months beginning June 1 of each calendar year.

(iv) **New Matters** refers to any issue, adjustment, and/or ambiguity in or for any account, method of accounting or estimation, or ratemaking topic that would directly or indirectly affect the Annual ARM Filing for which there is no explicit prior determination in this Docket 14-00146 by the Authority regarding the Company. The definition of "New Matters" includes, without limitation, any matter or item specifically described or set forth as a New Matter in this Settlement Agreement.

f. **Authorized Return on Equity:** The Parties stipulate and agree to an Authorized Return on Equity of 9.80% for the Rate Case portion of this Docket, which shall therefore be used in calculating the revenue sufficiency or deficiency under the ARM Tariff.

g. **Methodologies for Calculation of Annual Revenue Requirement and Resulting Sufficiency or Deficiency for each Forward Looking Test Year.** The revenue requirement and resulting sufficiency or deficiency shall be calculated using the ratemaking methodologies explicitly defined and set out in this Settlement Agreement ("Approved Methodologies").

(i) **Billing Determinants and Revenue at Present Rates**

A. **Forward Looking Test Year Billing Determinants** – In calculating Settlement Forward Looking Test Year Billing Determinants, the Company shall begin with Historic Base Period sales and transportation volumes, bills and billing demand units. The Company shall then adjust the billing determinants for normal

weather, annualized customer usage and customer growth to arrive at Forward Looking Test Year Billing Determinants. The weather adjustment shall be calculated using the weather data from the Bristol, Knoxville, Nashville and Paducah weather stations to normalize sales data, and the Company shall use the daily normal weather for the 30-year period ending at the end of each Historic Base Period. For industrial and transportation customers the Company shall analyze the sales volumes of the Company's largest customers and adjust volumes accordingly based on any known and measurable changes expected for each Forward Looking Test Year. For residential and commercial customers the Company shall use a two year average, with the last year being the Historic Base Period, to calculate customer growth adjustments. The customer change shall then be multiplied by annualized normal usage per customer to arrive at the adjustment to volumes consistent with the applicable tariffs, rules and regulations.

B. **Forward Looking Test Year Revenues** – Forward Looking Test Year Revenues shall be calculated by multiplying the Forward Looking Test Year Billing Determinants by the rates effective at the end of the Historic Base Period consistent with Schedule 11-2 to this Settlement Agreement.

C. **Weather Normalization** – The weather adjustment shall be calculated using the weather data from the Bristol, Nashville,

Knoxville (TN) and Paducah (KY) NOAA weather stations to normalize actual usage for all customers served under Rate Schedule (210), (211), (220), (221) and (225), as well as the commercial sales customers under Rate Schedule (230). From this data a 30–year daily normal ending at the conclusion of the Historic Base Period shall be calculated. Monthly normal cycle degree days shall be calculated from the 16th of the previous month to the 15th of the current month to approximate cycle-billing. Weather normalization months shall be the periods from October through April. Normalized HDDs by weather station for the Historic Base Period ending June 30, 2014 are attached as Attachment D to this Settlement Agreement. Beginning with the Company's initial Annual ARM Filing on February 1, 2016, the normalized HDDs will be presented as of the end of each Historic Base Period ending September 30th of each year. Weather normalization shall continue to be subject to annual TRA audit and the Consumer Advocate shall have the right to intervene in any docket related to the audit. Atmos Energy agrees not to object to any such intervention by the Consumer Advocate.

D. **Other Revenues** – The Company shall calculate Other Revenues, consisting primarily of forfeited discounts and miscellaneous service charges, by calculating a two year average of these amounts up to the end of each Historic Base Period.

E. **Cost of Gas** -- The Company shall calculate Cost of Gas by using the Historic Base Period per books cost of gas adjusted to remove rent for Intercompany Leased Storage Property to arrive at the Forward Looking Test Year Cost of Gas.

h. **Operations and Maintenance Expense ("O&M").** Total O&M excluding Cost of Gas shall be comprised of expenses incurred directly in the Company's Tennessee operations and expenses allocated from the three rate divisions that allocate expenses to Tennessee (Division 091, the Kentucky Mid-States General Office; Division 002, Shared Services General Office; and Division 012, Shared Services Customer Service). The forecast for O&M shall be developed independently for each of the four rate divisions using the forecast methodologies defined below. For divisions 091, 002 and 012, the amount of expense shall be allocated to the Tennessee operation as described in the Company's Cost Allocation Manual (CAM).

(i) **Labor** – Labor expense shall be equal to the Company's most recently completed and approved budget for the months of the Forward Looking Test Year for which the budget is available. Labor expense shall be forecasted using an inflation factor to adjust the months of the Forward Looking Test Year that extend beyond the Company's most recently completed budget. The inflation factor shall be the Company's budgeted average target common merit increase from its most recently completed budget.

The development of the O&M forecast shall be consistent for each entity that allocates costs to Tennessee. For divisions 091, 002 and 012, the appropriate amount of expense shall be allocated to the Tennessee operation as described in the Company's Cost Allocation Manual (CAM).

(ii) **Non-Labor (excluding rent, FAS 87 accrual, disallowances and bad debt expenses)** -- Non-labor O&M expense types other than otherwise noted above and below shall be equal to the Company's most recently completed budget for the months of the Forward Looking Test Year for which the budget is available. Non-labor expense types other than otherwise noted below are forecasted using a standard inflation factor to adjust the months of the Forward Looking Test Year that extend beyond the Company's most recently completed budget. The inflation factor used is the average inflation rate for the southern region over the previous two years as reported by the U.S. Department of Labor. The development of the O&M forecast shall be consistent for each entity that allocates costs to Tennessee. For divisions 091, 002 and 012, the appropriate amount of expense shall be allocated to the Tennessee operation as described in the Company's Cost Allocation Manual (CAM).

(iii) **Rent** – The Company shall use a 0% inflation factor for lease payments (subaccounts 05481 and 05480). For the Forward

Looking Test Year ending May 31, 2016 used in this Docket, the Company shall include in its O&M forecast the adjustments documented and described in the response to CAPD DR 1-58 (removal of the Franklin building from the plant additions forecast and addition of lease payments previously removed) (attached as Attachment I).

(iv) **FAS 87 accrual** – The Company shall remove from O&M any amounts related to FAS 87 expenses (subaccount 01202, and any amount in any successor or replacement account or subaccount containing FAS 87 expenses). In years that the Company makes actual cash contributions to its pension fund, it shall be allowed to recover those cash contributions as part of the annual reconciliation process described below. The amount of cash contribution allocable to and recoverable from Tennessee shall be consistent with the methodology represented in WP 4-4 of this Settlement Agreement and be based on the amount of future liability allocable to Tennessee as defined by the Company's actuary. The allocation methodology described is consistent with that used in Docket Nos. 08-00197 and 12-00064.

(v) **Disallowances** – The Company shall remove from O&M amounts related to incentive compensation, spousal and dependent travel, and non-deductible dues. Specifically, the Company shall remove allocated net expense amounts for incentive compensation, spousal

and dependent travel, and non-deductible dues budgeted in the following subaccounts: 07452, 07458, 07460, 07463, 07454, 07450, 05416, and 05412, as well as any subaccount that in form or substance could constitute a successor or replacement for such subaccount.

(vi) **Bad Debt Expense** – The Company shall calculate and include in O&M 0.5% of expected residential, commercial and public authority gross margins as calculated on WP 4-3 of this Settlement Agreement.

(vii) **Rate Case Expense** – The Company shall include an annual amount of $175,000 in the Forward Looking Test Year O&M to account for a 3 year amortization of the estimated rate case expenses for this Docket. Upon completion of this Docket, the Company shall defer accumulated rate case expenses and begin amortizing the actual balance at $14,583.33 per month until the actual balance is fully amortized. In the Forward Looking Test Year following the full amortization of the rate case expense balance, the Company shall cease to include in O&M an adjustment for rate case expense. The Company shall include in its normal operating budget an estimated amount for legal expenses as it would any other O&M expense. Legal expenses associated with prosecuting the Company's Annual ARM Filing are expected to be annually recurring and significantly lower than

the level required to prosecute a traditional rate case. The annual expense incurred for such legal expenses shall be subject to the annual reconciliation described below just like any other O&M expense.

(viii) **Other** - An adjustment for intercompany leased property shall be included consistent with the data and calculations on WP 3-1 attached to this Settlement Agreement and all previous rate filings made by the Company since 1989.

i. **Taxes, Other than Income Taxes**

(i) Total Taxes, Other than Income Taxes shall be comprised of taxes incurred directly in the Company's Tennessee operations and taxes allocated from the three rate divisions that allocate expenses to Tennessee (Division 091, the Kentucky Mid-States General Office; Division 002, Shared Services General Office; and Division 012, Shared Services Customer Service). The forecast for Taxes, Other than Income Taxes shall be developed independently for each of the four rate divisions. For divisions 091, 002 and 012, the appropriate amount of taxes shall be allocated to the Tennessee operation as described in the Company's Cost Allocation Manual (CAM). The forecast for Taxes, Other Than Income Taxes shall be comprised of the Company's most recently completed budget for each type of tax with the following two exceptions:

A. Payroll taxes (FICA, FUTA, SUTA) shall be inflated at the same rate as labor O&M for months in the Forward Looking Test Year that extend beyond the most recently completed budget; and

B. The monthly accrual for ad valorem taxes shall be the Company's most recent monthly accrual for estimated ad valorem taxes due.

(ii) An adjustment for intercompany leased property shall be included consistent with the data and calculations on WP 3-1 attached to this Settlement Agreement and all previous rate filings made by the Company since 1989.

j. **Depreciation and Amortization Expense**

(i) Depreciation and Amortization Expense for each Forward Looking Test Year shall be calculated within the Company's plant forecast described below. Depreciation expense shall be calculated by multiplying the approved rate for each account by the projected account balance for each month. The depreciation rates used to calculate depreciation expense are those most recently approved by the Authority for Tennessee and each of the entities allocable to Tennessee. Depreciation expense allocable to Tennessee shall be done in accordance with the Company's Cost Allocation Manual (CAM).

(ii) For the attrition years ending May 31, 2016 and May 31, 2017, the Company shall include in Amortization Expense $649,245 each

year to account for a 2-year amortization of the regulatory asset related to FAS 87 which it was authorized to establish in the Order from Docket No. 12-00064. The regulatory asset will be fully amortized on May 31, 2017.

(iii) Prudent rate making and accounting requires that depreciation rates be updated periodically. The Company's practice is to conduct depreciation studies and update rates in its various operating divisions and entities housing shared assets (including the Kentucky Mid-States General Office and SSU) every 4-6 years. The Company does plan to conduct depreciation studies in the future consistent with this practice and prudent accounting and rate making procedures. In the event it conducts a depreciation study for its Tennessee operations or any of the entities that house shared assets that support Tennessee operations, the Company shall, within 30 days of completing the study, file the depreciation study with the TRA, and provide a copy to the Consumer Advocate, and ask that the rates contained in the study be approved for its next annual review. Following any appropriate discovery and rebuttal, and conditioned upon approval by the TRA of new rates, the Company shall calculate depreciation expense using the newly approved rates in its subsequent Annual ARM Filing. To assist with review, the Company shall file any new depreciation study

when it is completed, rather than waiting until it makes the next Annual ARM Filing.

(iv) An adjustment for intercompany leased property shall be included consistent with the data and calculations on WP 3-1 attached to this Settlement Agreement and all previous rate filings made by the Company since 1989.

k. **Rate Base** The rate base shall include projected thirteen month averages for each of the following components. Each component shall be forecasted consistent with the methodologies described in each section below:

(i) **Original Cost of Plant** – The forecast of monthly gross plant balances shall begin with the actual plant balances at the end of the Historic Base Period. Plant additions for the period between the end of the Historic Base Period and end of the Forward Looking Test Year are made up of projected and budgeted plant additions from the Company's monthly projections and most recently completed capital budget. Plant additions are comprised of three components:

(A) the capital spending for Tennessee;

(B) the amount allocated to Tennessee resulting from capital spending by the KY/Mid-States Division's general office; and

(C) the amount allocated to Tennessee resulting from capital spending by the Company's Shared Services (SSU) during the Forward Looking Test Year.

Two components of SSU that house shared plant assets, the Charles K. Vaughan Center (CKV) and Greenville data center, shall use allocation percentages that recognize the unique nature and use of those assets and that are consistent with the Company's workpapers. The capital forecast shall be converted to plant account ("300 account") detail for the purpose of projecting additions, retirements, depreciation expense, accumulated depreciation and resulting net plant at the required level of detail. Projected plant retirements shall be based on the level of retirements recorded during each Historic Base Period. For the initial Forward Looking Test Year ending May 31, 2016, the Company shall include in its rate base forecast the adjustments documented and described in the response to CAPD DR 1-58 (removal of the Franklin building from the plant additions forecast and addition of lease payments previously removed), attached as Attachment I.

(ii) **Accumulated Depreciation and Amortization** – Accumulated depreciation and amortization for each Forward Looking Test Year shall be forecast within the Company's plant projection described in the preceding section and shall incorporate the most recently

approved depreciation rates. The forecast shall begin with actual per books accumulated depreciation balances at the end of the Historic Base Period. For each month between the end of each Historic Base Period and the end of each Forward Looking Test Year, the forecast shall add projected depreciation expense and deduct the same retirements that were projected for gross plant. Depreciation expense shall be calculated by multiplying the approved rate for each account by the projected account balance for each month.

(iii) **Construction Work in Progress ("CWIP")** – The balance of CWIP at the end of each Historic Base Period shall be projected to remain constant through the end of each Forward Looking Test Year as capital spending is offset by completing projects and placing assets in service.

(iv) **Storage Gas Investment** - Forward Looking Test Year storage gas balances shall be based on actual balances through the end of each Historic Base Period and forecasted storage usage with future injections priced at NYMEX futures prices.

(v) **Cash Working Capital** - The Company conducted a new lead-lag study for this Docket in order to calculate cash working capital requirements. Rather than conduct a new lead-lag study with each Annual ARM Filing, the Company shall apply the lead-lag factors from this study to the subsequent annual Forward Looking Test

Year cost of service items and revenues in order to calculate cash working capital requirements each Forward Looking Test Year.

(vi) **Materials and Supplies** - The balance of materials and supplies at the end of each Historic Base Period shall be projected to remain constant through the end of each Forward Looking Test Year.

(vii) **Regulatory Assets** - Attachment F lists the regulatory assets that are recognized for the Company. Attachment F shall include the Deferred Pension Regulatory Asset that is more particularly described below.

(viii) **Deferred Pension Regulatory Asset Balance** - The Company shall include in rate base the average unamortized portion of the regulatory asset related to FAS 87 which it was authorized to establish in the Final Order from Docket No. 12-00064. The regulatory asset will be fully amortized on May 31, 2017. No further regulatory asset for FAS 87 shall be established unless so established by the TRA, and until the TRA adopts new ratemaking methodologies thereto.

(ix) **Accumulated Deferred Income Tax** – Accumulated Deferred Income Taxes ("ADIT") shall be forecasted consistent with this Settlement Agreement and shall be based on forecasted plant additions and currently enacted tax law. The forecast of monthly ADIT balances shall begin with the actual ADIT balances at the end of the Historic Base Period. The forecast of book plant

additions and book depreciation for the period between the end of the Historic Base Period and end of the Forward Looking Test Year shall be consistent with the amounts described above in (k)(i) and (k)(ii). To arrive at tax plant additions, the tax repairs basis adjustment shall be estimated based on the type of projected book plant additions and prior period deductible percentages. In periods for which bonus depreciation has been enacted, the bonus depreciation basis adjustment shall be estimated based on the type of projected book plant additions, using the last known bonus depreciation percentages, by rate division. Projected tax plant additions shall be used to compute tax projected depreciation in accordance with the current MACRs rates. The difference between projected book plant additions and projected tax plant additions results in projected fixed asset cost ADIT. The difference between projected book accumulated depreciation and projected tax accumulated depreciation results in projected fixed asset accumulated ADIT. All other ADIT balances shall be held constant from the end of the Historic Base Period: only fixed asset cost and accumulated ADIT are projected. ADIT balances for Tennessee and each rate division allocable to Tennessee shall include both liability and asset balances including NOLCs. ADIT shall include a ratemaking adjustment consistent with the

Company's pre-filed testimony to remove non-utility related ADIT associated with any consolidated tax net operating loss.

(x) **Customer Advances for Construction** – The balance of customer advances for construction at the end of each Historic Base Period shall be projected to remain constant through the end of each Forward Looking Test Year.

(xi) **Customer Deposits** – Customer deposits shall be projected to increase 0.35% annually from the ending balance in each Historic Base Period.

(xii) **Accumulated Interest on Customer Deposits** – Accumulated interest on customer deposits shall be projected to increase 0.35% annually from the ending balance in each Historic Base Period.

(xiii) **Operating Reserves** – Operating Reserves shall not be included as a component of rate base.

(xiv) **Net Elimination of Intercompany Leased Property** – An adjustment for intercompany leased property shall be included consistent with the data and calculations on WP 3-1 and all previous rate filings made by the Company since 1989.

l. **Rate of Return**

(i) **Capital Structure** - The Company's capital structure shall be calculated annually and be made up of:

A. Actual equity balance at the end of each Historic Base Period

B. Actual long term debt ("LTD") balance at the end of each Historic Base Period

C. Twelve-month average short term debt ("STD") balance for the 12 months that comprise each Historic Base Period

(ii) **Cost of Debt** - Cost of Long Term Debt shall be calculated annually as it is calculated on WP 9-3 of this Settlement Agreement. Cost of Short Term Debt shall be calculated annually as it is calculated on WP 9-2 of this Settlement Agreement.

(iii) **Return on Equity** – The Authorized Return on Equity shall be 9.80% until a different return on equity is adopted by the Authority in a subsequent general rate case.

m. **Other Methodologies Adopted --** To the extent that ratemaking methodologies are not described in this Settlement Agreement and are not inconsistent with any methodology 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; provided, however, that to the extent that any such methodology is or could be interpreted as ambiguous or contradictory, no methodology shall be inferred with respect to the item or process that is ambiguous or contradictory.

14. **Annual Reconciliation of Actual Results to Authorized Return on Equity**

a. On or before September 1 of each year, the Company shall file with the Authority, and shall provide a copy to the Consumer Advocate, a reconciliation of actual results ("Annual Reconciliation") to the Authorized Return on Equity for the Forward Looking Test Year immediately completed.

b. 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. Actual cost of service shall be compared with actual booked revenue, ignoring the revenue impact of any prior year reconciliation, to determine the revenue requirement ("Annual Reconciliation Revenue Requirement") necessary to adjust the actual return on equity to the Authorized Return on Equity for the Forward Looking Test Year immediately completed, all determined in accordance with the Approved Methodologies. The calculation of the Annual Reconciliation Revenue Requirement shall be consistent with Schedule 12 of the ARM Tariff (Attachment C). Interest will be added to the Annual Revenue Reconciliation Revenue Requirement (whether positive or negative). The interest rate shall be the Overall Cost of Capital as stated on Schedule 9 of the Annual ARM Filing Compounded for 2 years.

c. New rates shall be calculated to produce a net rate adjustment comprised of the Annual Reconciliation Revenue Requirement from the most recently completed Forward Looking Test Year and the revenue sufficiency/deficiency for the ensuing Forward Looking Test Year, all determined in accordance with the methodologies set forth herein and as approved and adopted by the Authority.

d. The resulting rates shall be effective on bills rendered on and after June 1 of each year. All tariff rates (except Special Contract rates, which shall not be affected) shall be adjusted in proportion to the relative base revenue share of each class as described above.

e. The first Annual Reconciliation Revenue Requirement filing shall occur on September 1, 2016, and shall cover the Forward Looking Test Year ended May 31, 2016. The resulting Annual Reconciliation Revenue Requirement shall be incorporated into the Company's February 1, 2017 Annual ARM Filing.

15. **Variance Report and ARM Review --** As part of its Annual ARM Filing, Atmos Energy shall prepare and file with the TRA, with a copy to the Consumer Advocate, a Variance Report ("Variance Report") that identifies and explains each and every Atmos Energy operating revenue and expense account and/or subaccount for which the Tennessee amount (including amounts allocated to Tennessee) either:

a. exceeds the prior year's amount (based on amounts either as filed by Atmos Energy in the Annual ARM Filing or as adjusted by the TRA under Tenn. Code Ann. § 65-5-103(d)(6)(C)) by 5% and $30,000; or

b. exceeds the amount (based on amounts either as filed by Atmos Energy in the Annual ARM Filing or as adjusted by the TRA under Tenn. Code Ann. § 65-5-103(d)(6)(C)) in such account and/or subaccount in the third preceding year by 10% and $60,000; or

c. has been, when compared with the accounts and/or subaccounts existing on the Effective Date of this Settlement Agreement and/or used in the calculations referenced herein, added or deleted or modified in form or substance in any way.

As to any account and/or subaccount (and including without limitation any process related directly or indirectly to any such account or subaccount) included on a Variance Report, the TRA and/ or Consumer Advocate shall have the right in its discretion to request additional information and an explanation from Atmos Energy. Atmos Energy agrees to provide any such information or explanation requested within ten business days of such request. The Consumer Advocate, further, has the right in its discretion to bring such account and/or subaccount (or related process) to the attention of the Authority and to request the Authority to review and consider such account and/or subaccount (or related process). Without limiting the Authority's discretion, the Consumer Advocate may recommend any form or process of review it deems appropriate, including without limitation a review that would include the appointment of a third party to review and report on the account and/or subaccount (or related process).

16. **CAPD Authority to Petition** -- The CAPD shall have the right in its sole discretion to file a petition or complaint asking the TRA to terminate or modify any ARM Tariff resulting from this Docket or any directly or indirectly related docket or to take any other action contemplated by Tenn. Code Ann. § 65-5-103(d)(6). Atmos Energy agrees not to oppose the

CAPD's petition or complaint filed under this Section on the grounds that such a proceeding is not statutorily authorized or that CAPD is not authorized to bring such a proceeding; provided, however, that Atmos Energy reserves all rights with regard to the merits of any termination or modification or other relief that the CAPD may request or position that the CAPD may assert in any such proceeding.

17. The Parties agree that the terms of this Settlement Agreement are fair and reasonable to all customer classes and will provide Atmos Energy with a reasonable opportunity to recover the agreed upon operating revenue requirement and a reasonable rate of return on investment.

18. The Parties agree to support this Settlement Agreement before the Authority and in any hearing, proposed order, or brief conducted or filed in this proceeding.

19. The Parties acknowledge that Atmos Energy brought this matter, *inter alia*, to determine rates in a general rate case and to establish adopted ratemaking methodologies sufficient to enable implementation of the annual review mechanism established by Tenn. Code Ann. § 65-5-103(d)(6). The Parties jointly request that the Authority adopt the ratemaking methodologies set forth in this Settlement Agreement for the limited purpose of implementing an annual review mechanism under Tenn. Code Ann. § 65-5-103(d)(6) under this Docket, and approve the annual review mechanism and ARM Tariff consistent with the terms and requirements established by this Settlement Agreement. The methodologies adopted by the Authority as a result of the above request shall be utilized in preparing and evaluating each Annual ARM Filing and Annual Reconciliation filing contemplated under this Docket.

20. None of the Parties waives its right to take other positions with respect to matters similar to those settled herein in future proceedings before the Authority.

21. The resolution of issues reflected herein is the result of give and take negotiations between the Parties and does not necessarily reflect the position of any single Party on any discrete issue, and no Party waives the right to assert any position in any future proceeding.

22. Except to the limited extent necessary to allow the Authority to implement an annual review mechanism under Tenn. Code Ann. § 65-5-103(d)(6) in this Docket (and, for the avoidance of doubt, only in this Docket 14-00146), the Parties acknowledge and agree as follows:

a. This Settlement Agreement shall not have any precedential effect in any other proceeding or be binding upon any of the Parties in this or any other jurisdiction;

b. None of the signatories hereto shall be deemed to have acquiesced in any ratemaking or procedural principle, including without limitation, any cost of service determination or cost allocation or revenue related methodology,

c. No provision of this Settlement Agreement shall be deemed an admission of any Party.

23. The Parties agree that all pre-filed testimony and exhibits and attachments of the Parties (including pre-filed supplemental testimony and exhibits and attachments supporting this Settlement Agreement) will be admitted into evidence without objection and become part of the public record and the Parties hereby waive their right to cross-examine all witnesses with respect to such pre-filed testimony and exhibits and attachments; provided, however, that should questions be asked of such witnesses by any person at the hearing of this matter (including any questions by Directors), the Parties may cross-examine any witness with respect to such

questions consistent with the agreement set forth in this Settlement Agreement. As to the Supplemental Testimony that is the subject of the Consumer Advocate's Motion for Leave to File Supplemental Testimony filed on April 21, 2015, and any rebuttal thereto, the parties shall abide by the hearing officer's decision. Public comment regarding the Settlement Agreement will also be welcome and encouraged by the Parties.

24. The terms of the Settlement Agreement have resulted from extensive negotiations between the signatories and the terms hereof are interdependent. The provisions of this Settlement Agreement are agreements reached in compromise and settlement and solely for the purpose of resolving this Docket without the need for further litigation.

25. The provisions of this Settlement Agreement are not severable.

26. The Parties jointly recommend that the Authority issue an order adopting this Settlement Agreement in its entirety without modification.

27. If the Authority does not approve the settlement in its entirety, the Parties are not bound by any position or term set forth in this Settlement Agreement, except for this Section. In the event that the Authority does not approve this Settlement Agreement in its entirety, each of the signatories to this Settlement Agreement will retain the right to terminate this Settlement Agreement and/or to seek additional time to consider or review any proposed modifications. By agreeing to this Settlement Agreement, no Party waives any right to continue litigating this matter should the Settlement Agreement be rejected or modified, in whole or in part, by the Authority.

28. The Parties agree that this Settlement Agreement constitutes the complete understanding among the Parties concerning the resolution of issues and matters under this TRA Docket 14-00146, and any oral statements, representations or agreement concerning such issues

and matters made prior to the execution of this Settlement Agreement have been merged into this Settlement Agreement.

29. The Consumer Advocate's agreement to this Settlement Agreement is expressly premised upon the truthfulness, accuracy and completeness of the information provided by the Company to the Consumer Advocate throughout the course of this Docket, which information was relied upon by the Consumer Advocate in negotiating and agreeing to the terms and conditions of this Settlement Agreement.

30. The acceptance of this Settlement Agreement by the Attorney General shall not be deemed approval by the Attorney General of any of the Company's practices.

31. Each signatory to this Settlement Agreement represents and warrants that it/he/she has informed, advised and otherwise consulted with the Party for whom it/he/she signs regarding the contents and significance of this Settlement Agreement and has obtained authority to sign on behalf of such Party, and based upon those communications, each signatory represents and warrants that it/he/she is authorized to execute this Settlement Agreement on behalf of its/his/her respecting Party.

32. This Settlement Agreement shall be governed by and construed under the laws of the State of Tennessee. Nothing herein limits or alters the Sovereign Immunity of the State of Tennessee or any of its entities or subdivisions.

33. The Parties agree that this Settlement Agreement may be executed in multiple counterparts and by copies provided by facsimile or in .pdf format.

34. The date set forth immediately following shall be the "Effective Date" for purposes of this Settlement Agreement.

The foregoing is agreed and stipulated to this 29th day of April, 2015.

STIPULATION AND SETTLEMENT AGREEMENT
IN TRA DOCKET 14-00146
SIGNATURE PAGE

ATMOS ENERGY CORPORATION

A. Scott Ross, #15634
Blind Akrawi, #23213
Neal & Harwell, PLC
2000 One Nashville Place
150 Fourth Avenue, North
Nashville, TN 37219-2498
(615) 244-1713 – Telephone

Dated: April 29th, 2015

STIPULATION AND SETTLEMENT AGREEMENT
IN TRA DOCKET 14-00146
SIGNATURE PAGE

CONSUMER ADVOCATE AND PROTECTION DIVISION

Herbert H. Slatery III, #09077
Attorney General and Reporter

Wayne M. Irvin, #30946
Assistant Attorney General
Office of the Attorney General
Consumer Advocate and Protection Division
P. O. Box 20207
Nashville, TN 37202-0207

Dated: April 29, 2015

BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION

NASHVILLE, TENNESSEE

January 15, 2019

IN RE:	)	
	)	
PETITION OF CHATTANOOGA GAS	)	
COMPANY FOR APPROVAL OF AN	)	
ADJUSTMENT IN RATES AND TARIFF; THE	)	**DOCKET NO.**
TERMINATION OF THE AUA MECHANISM	)	**18-00017**
AND THE RELATED TARIFF CHANGES AND	)	
REVENUE DEFICIENCY RECOVERY; AND AN	)	
ANNUAL RATE REVIEW MECHANISM	)	

AMENDED ORDER

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This matter came before Chair Robin L. Morrison, Vice Chair Kenneth C. Hill and Commissioner David F. Jones of the Tennessee Public Utility Commission (the "Commission" or "TPUC"), the voting panel assigned to this docket, during a regularly scheduled Commission Conference held on October 15, 2018, for consideration of the *Chattanooga Gas Company Petition for Approval of an Adjustment in Rates and Tariff; the Termination of the AUA Mechanism and the Related Tariff Changes and Revenue Deficiency Recovery; and an Annual Rate Review Mechanism* ("*Petition*") filed on February 15, 2018 by Chattanooga Gas Company ("CGC" or "Company"). In its *Petition*, CGC seeks Commission approval to adjust rates for natural gas service, terminate the AUA mechanism and reinstitute the WNA mechanism for R-1 and C-1 customers and recover an associated customer revenue deficiency, and opt in to an annual rate review under the alternative regulatory methods statute.

I. BACKGROUND AND *PETITION*

CGC is a public utility authorized to transport, distribute and sell natural gas in the Chattanooga area, Cleveland, Tennessee, and other areas within Hamilton and Bradley counties.[1] CGC serves over 57,000 residential households and approximately 8,500 commercial and industrial customers.[2] CGC is a wholly-owned subsidiary of Southern Company Gas, a natural gas company offering service in Florida, Georgia, Illinois, New Jersey, Maryland and Virginia.[3] CGC's parent company, Southern Company Gas, which was formerly known as AGL resources, was acquired by the Southern Company in 2016. Overall, the Southern Company provides natural gas and electric services to more than 9 million customers in 18 states.[4]

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[1] *Chattanooga Gas Company Petition for Approval of an Adjustment in Rates and Tariff; the Termination of the AUA Mechanism and the Related Tariff Changes and Revenue Deficiency Recovery; and an Annual Rate Review Mechanism*, p. 2 (February 15, 2018).
[2] CGC Monthly Report, on file with Commission (May 31, 2018).
[3] *Petition*, p. 2 (February 15, 2018).
[4] *Id.*

Prior to the instant case, CGC's most recent rate case was Docket No. 09-00183, filed in 2009.[5] The Company states that without the relief sought, it projects to realize a rate of return of 4.61%. Further, CGC desires to meet new growth and continue providing adequate natural gas in compliance with state and federal compliance standards. CGC specifically requests in its *Petition*, a rate of return of 7.83% and revenue increase of $6,995,194 based on an Attrition Year of July 1, 2018 to June 30, 2019.[6] CGC states that the growth in Hamilton and Bradley counties, such as the addition of Volkswagen, Wacker, and Amazon facilities, along with the commercial districts and residential developments that follow them, support the requested 29.8 million in capital budget expenditures. The Company also states that these capital expenditures will allow it to meet Commission safety compliance requirements and to improve the reliability of its system.[7] The *Petition* also states that all known and measurable impacts of the Tax Cuts and Jobs Act ('the Act"), which became effective January 1, 2018, are incorporated into the filing and that the Commission's directives in Docket 18-00001[8] are accomplished by incorporation of the tax effects into this proceeding.[9]

CGC also requests in its *Petition* to terminate the Alignment and Usage Adjustment ("AUA") and revert the R-1 and C-1 AUA customers back to the Weather Normalization Adjustment ("WNA"). As part of this request, the Company seeks to recover nearly $2 million[10] of unrecovered customer AUA revenue through the Interruptible Margin Credit Rider

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[5] *Id.* at 5.
[6] *Id.* at 3-5.
[7] *Id.* at 5-8.
[8] The Commission placed certain requirements on the five largest utilities, which includes CGC, following its investigation of the impacts of Federal Tax reform on public utility revenues. *See, In Re: Tennessee Public Utility Commission Investigation of Impacts of Federal Tax Reform on the Public Utility Revenue Requirements*, Docket No. 18-00001, Order Approving Staff Report and Recommendations, (October 1, 2018).
[9] *Petition*, at 8-9.
[10] The amount of the deficiency at the time of filing of the *Petition* was $1.9 million, but at the time of the Hearing, the deficiency had been reduced to $1.4 million before interest. *See* Transcript of Hearing, Vol. II C, p. 209 (August 21, 2018).

("IMCR").[11]

CGC also requests in its *Petition* to opt into an annual rate review under the alternative regulatory methods ("ARM") statute, pursuant to Tenn. Code Ann. § 65-5-103(d)(1)(A).[12] Subsequently, however, the Company gave notice of its withdrawal of its request for approval of its ARM.[13]

Along with its *Petition*, CGC filed Minimum Filing Guidelines, a revised Tariff and the pre-filed direct testimony and exhibits of CGC's witnesses: Wendell Davis, Heath Brooks, Rachel Johnson, James Vander Weide, Dan Yardley, Dane Watson, Michael Adams, Archie Hickerson, Gregory Becker and John Cogburn. The Company also filed a *Proposed Protective Order* and a *Proposed Procedural Schedule* on the same date as the filing of its *Petition.*

II. TRAVEL OF THE CASE

The Consumer Protection and Advocate Division of the Attorney General ("Consumer Advocate") filed a *Petition to Intervene* on March 9, 2018. The Chattanooga Regional Manufacturers Association ("CRMA") filed a *Petition for Leave to Intervene* on March 8, 2018. The Consumer Advocate also filed a *Proposed Agreed Protective Order* on March 2, 2018 and a *Proposed Procedural Schedule* on March 9, 2018.

The Hearing Officer issued the *Agreed Protective Order* on March 13, 2018. Subsequently, the Hearing Officer entered an *Order Granting the Petition to Intervene Filed By the Consumer Advocate*, an *Order Granting the Petition to Intervene Filed By the Chattanooga Regional Manufacturers Association*, and an *Order Establishing Procedural Schedule* on March 23, 2018. The parties commenced the submission of discovery requests and responses. During

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[11] *Petition*, p. 8-16.
[12] *Id.* at 16-19.
[13] *Chattanooga Gas Company Notice of Withdrawal from Further Consideration in this Docket of its Requests for Approval of its Proposed Alternative Regulatory Methods* (April 10, 2018).

the discovery process, CGC submitted revised testimony for John M. Cogburn, Archie R. Hickerson and Wendell Dallas. In addition, CGC submitted the pre-filed testimony of Gary Tucker in substitution for the pre-filed testimony of Rachel Johnson.[14] In responding to certain discovery requests submitted by the Consumer Advocate, CGC identified errors on certain schedules and subsequently in late May 2018 submitted revised schedules correcting these errors. This revision maintains the requested overall return of 7.83% with a revised rate increase of approximately $6.2 million.[15]

The Consumer Advocate submitted pre-filed testimony of its rebuttal witnesses, Christopher C. Klein, Ph.D., David Dittemore and William H. Novak. CRMA filed the direct testimony of its witnesses, Randy Carter and David Klinger on July 3, 2018. CGC submitted rebuttal testimony of Wendell Dallas, Dr. James H. Vander Weide, Michael J. Morely, Michael J. Adams, John M. Cogburn, James Barvie, Jacob A. Ziliak, Heath J. Brooks, Gregory Macleod, Gary A. Tucker, Deborah A. Santolin, Daniel P. Yardley, Christopher Bellinger and Archie R. Hickerson on August 3, 2018. In addition, CGC submitted the pre-filed direct testimony of Deborah Santolin, substituting for the pre-filed direct testimony of Gregory Becker on the same date.

On July 26, 2018, the Hearing Officer issued a *Notice of Public Comment* providing members of the public an opportunity to provide oral comment in a public meeting presided by the Commission Chair at the University Center at the University of Tennessee-Chattanooga. An *Amended Notice of Public Comment* was filed on August 3, 2018 to correct the address of the University Center. An additional notice was provided upon the filing of the *Re-Notice of Public*

[14] Gary Tucker substituted as a witness for Rachel D. Johnson, who had originally submitted pre-filed direct testimony but subsequently left the employment of CGC. Mr. Tucker worked with Ms. Johnson and was able to adopt Ms. Johnson's testimony and thereby substitute for her as a witness. *See* Transcript of Hearing, Vol. I C, pp. 214-215 (August 20, 2018).

[15] Transcript of Hearing, Vol. I C, p. 219 (August 20, 2018).

Comment on August 7, 2018. At the Public Comment Meeting held by the Commission on August 9, 2018, customers of CGC provided statements regarding their experiences with CGC, the services provided by the Company, and the rates proposed in the *Petition.* Additionally, written comments were filed by members of the public. On August 15, 2018, CGC filed copies of the legal notices concerning the Hearing date and the proposed rate changes that were published in appropriate newspapers of general circulation, as required by TPUC Rule 1220-4-1-.05. CGC filed additional published legal notices concerning the Hearing date and proposed rate changes on August 28, 2019.

III. THE HEARING AND POST HEARING FILINGS

The Hearing on the merits of the *Petition* commenced in Nashville and was held on August 20, August 21 and August 22, 2018, as noticed by the Commission on August 10, 2018. Participating in the Hearing were the following parties and their respective counsel:

> Chattanooga Gas Company – **J.W. Luna**, Esq., Luna Law Group, PLLC, 333 Union Street, Suite 300, Nashville, Tennessee 37201; **Floyd R. Self**, Esq., Berger Singerman LLP, 313 North Monroe Street, Suite 301, Tallahassee Florida 32301.
>
> Consumer Protection and Advocate Division – **Wayne M. Irvin**, Esq. and **Daniel P. Whitaker, III**, Esq., Office of the Tennessee Attorney General, Public Protection Section, Consumer Protection and Advocate Division, P.O. Box 20207, Nashville, Tennessee 37202-0207.
>
> Chattanooga Regional Manufacturers Association – **Henry Walker**, Esq., Bradley Arant Boult Cummings, LLP, 1600 Division Street, Suite 700, Nashville, Tennessee 37203.

The panel heard testimony from CGC witnesses, Wendell Dallas, Dr. James H. Vaner Weide, Gregory Macleod, Dane Watson, Michael Adams, Heath Brooks, Gary Tucker, Michael J. Morley, Deborah Santolin, Jacob A. Ziliak, Christopher Bellinger, Daniel P. Yardley, Archie Hickerson, John Cogburn, and James Garvie. The Consumer Advocate presented witness testimony from William H. Novak, David Dittemore, and Dr. Christopher C. Klein. The parties

stipulated to the testimony of CRMA witnesses David Klinger and Randy Carter, who were made available for questions from the Commissioners or Commission Staff.[16] On each day of the Hearing, the panel solicited comments from the public, but no member of the public sought to be heard.[17]

The parties waived closing arguments at the Hearing in favor of filing Post-Hearing Briefs. The Hearing Officer issued an *Order Establishing Post-Hearing Procedural Schedule* on August 27, 2018. CGC filed updated information requested by Commission Staff during the Hearing on August 28, 2018. CGC, the Consumer Advocate and CRMA filed their Post-Hearing Briefs on September 10, 2018.

The Commission convened on October 15, 2018, during a regularly scheduled Commission Conference, which was duly noticed on October 5, 2018. The voting panel assigned to this matter deliberated, announced findings and conclusions upon consideration of the entire record, including all exhibits and the testimony of witnesses, and voted unanimously in favor of the finding and conclusions.[18]

IV. CRITERIA FOR ESTABLISHING JUST AND REASONABLE RATES

The Commission has jurisdiction to set the rates of public utilities operating in the State of Tennessee.[19] In setting rates for public utilities, the Commission balances the interests of the utilities subject to its jurisdiction with the interests of Tennessee consumers, i.e., it is obligated to fix just and reasonable rates.[20] A public utility possesses the burden of proof on a petition to approve an adjustment of its rates.[21]

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[16] Transcript of Hearing, Vol. III A, pp. 17-18 (August 22, 2018).
[17] Transcript of Hearing, Vol. I A, p. 7 (August 20, 2018); Transcript of Hearing, Vol. II A, p. 5, (August 21, 2018); Transcript of Hearing, Vol. III A, p. 70 (August 22, 2018).
[18] Transcript of Commission Conference, pp. 50-58 (October 15, 2018).
[19] Tenn. Code Ann. §§ 65-4-101(6); 65-4-104; 65-5-101, *et seq.*
[20] Tenn. Code Ann. § 65-5-101 (2018).
[21] Tenn. Code Ann. § 65-5-103(a) (2018).

The Commission must also approve a rate that provides the regulated utility an opportunity to earn a just and reasonable return on its investments.[22] The Commission considers petitions for a rate increase, filed pursuant to Tenn. Code Ann. § 65-5-103, in light of the following criteria:

1. The investment or rate base upon which the utility should be permitted to earn a fair rate of return;

2. The proper level of revenues for the utility;

3. The proper level of expenses for the utility; and

4. The rate of return the utility should earn.

There is no single, precise measure of the fair rate of return a utility is allowed an opportunity to earn. Therefore, the Commission must exercise its judgment in making an appropriate determination. The Commission, however, is not without guidance in exercising its judgment:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.[23]

In addition, the United States Supreme Court has determined that regulated utilities are entitled to a return that is "just and reasonable."[24] The rate a utility is permitted to charge should enable it "to operate successfully, to maintain its financial integrity, to attract capital, and to

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[22] *Bluefield Water Works and Improvement Company v. Public Service Commission of the State of West Virginia*, 262 U.S. 679, 43 S.Ct. 675 (1923).
[23] *Id.* at 692-693; *see also Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 (1989).
[24] *Federal Power Comm'n v. Hope Natural Gas Co.* 320 U.S. 591, 605 (1944).

compensate investors for the risks assumed."[25]

The general standards to be considered in establishing the fair rate of return for a public utility are financial integrity, capital attraction and setting a return on equity that is commensurate with returns investors could achieve by investing in other enterprises of corresponding risk.[26] Thus, rates established must allow a company to cover its operating expenses and provide an opportunity to earn a fair rate of return on a company's investment used to provision service. Further, a rate should be reasonable not only when it is first established, but also for a reasonable time thereafter.[27]

The Commission has wide discretion with regard to setting rates. The Commission may "utilize an historical test period, a forecast period, a combination of these where necessary, or any other accepted method of rate making necessary to give a fair rate of return."[28] The Supreme Court noted in *Powell Tel. Co. v. Tennessee Pub. Serv. Comm'n* that, "there is no statutory nor decisional law that specifies any particular approach that must be followed by the Commission. Fundamentally, the establishment of just and reasonable rates is a value judgment to be made by the Commission in the exercise of its sound regulatory judgment and discretion."[29] Accordingly, the Commission is not limited to adopting any particular approach or to adopting a specific test period in making known and measurable adjustments to produce just and reasonable rates.[30]

Applying these principles and criteria, and upon consideration of the entire record, including all exhibits and the testimony of the witnesses, the panel made the following findings and conclusions.

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[25] *Id.*
[26] *Id.* at 603.
[27] *McCardle v. Indianapolis Water Co.*, 272 U.S. 400, 408-409, 47 S.ct 144, 148 (1926); *Southern Bell Telephone & Telegraph Co. v. Tennessee Pub. Serv. Comm'n*, 304 S.W2d 640, 647 (1944).
[28] *Powell Tel. Co. v. Tennessee Pub. Serv. Comm'n,* 660 S.W.2d 44, 46 (Tenn.1983); *Am. Ass'n of Retired Persons v. Tennessee Pub. Serv. Comm'n,* 896 S.W.2d 127, 133 (Tenn.Ct.App.1994).
[29] *Powell*, 660 S.W.2d at 46.
[30] *CF Industries v. Tennessee Pub. Serv. Comm'n,* 599 S.W.2d 536, 543 (Tenn. 1980).

V. FINDINGS AND CONCLUSIONS

A. TEST PERIOD AND ATTRITION PERIOD

In a rate case, the Commission must decide the appropriate test period and attrition period to be utilized in the calculation of rates. Selecting the test period has the stated purpose of providing an indication of the rate of return that will be produced during the period under the existing rate structure in the reasonably foreseeable future. The test period takes into consideration the estimated effect of calculations related to revenues, expenses, and investments. As previously stated, the Commission has wide discretion with regard to this decision.

The Company selected a historical test period of the twelve months ending June 30, 2017 and an attrition period of the twelve months ending June 30, 2019. CGC utilizes a combination of historical booked amounts with normalizing adjustments and historical growth rates, plus its annual budgeted process for forecasting attrition period revenue, expense, and rate base amounts.

The Consumer Advocate chose a test period of the twelve months ending December 31, 2017 and an attrition period of the twelve months ending December 31, 2019. The Consumer Advocate develops its attrition period revenue, expense and rate base amounts based on historical test period averages of booked amounts with normalizing adjustments. The Consumer Advocate then applies historical growth rates along with a national consumer price index to arrive at attrition period amounts.

The Commission noted that, in general, the most recent normalized test period is the most appropriate base to be used in forecasting because recent results are generally more reflective of future outcomes. Applying this principle to the instant case, the panel found the later test period of the twelve months ending December 31, 2017 utilized by the Consumer Advocate was the appropriate test period and, accordingly, voted unanimously to adopt it. The panel also voted

unanimously to adopt the Company's attrition period of the twelve months ending June 30, 2019, finding that the evidence in the record better supports this attrition period.

B. Revenues (Including Cost of Gas and Margin Calculation)

Total Operating Margin consists of the sum of Base Revenues, Other Revenues and Allowance for Funds Used during Construction (AFUDC), less the Cost of Gas. Table 1 below summarizes the differences between the Company's and the Consumer Advocate's forecasted Attrition Period Total Operating Margin, as well as that adopted by the voting panel of the Commission. A discussion of each component follows.

Table 1

	Company[31]	Consumer Advocate[32]	Commission Panel
Operating Revenues:			
Gas Sales Revenue	$69,644,006	$74,740,093	$70,473,655
Other Revenue	612,767	675,121	675,121
AFUDC	900,355	340,214	823,951
Total Operating Revenues	**$71,157,128**	**$75,755,428**	**$71,972,727**
Less Cost of Gas	37,973,978	42,765,421	38,611,525
Total Operating Margin	**$33,183,150**	**$32,990,007**	**$33,361,202**

B(1). Gas Sales Revenues

Gas sales revenues are forecasted by adjusting the test period billing determinants for the impacts of normal weather, annualized customer usage, and customer growth to arrive at the attrition period billing determinants. Attrition period billing determinants are then multiplied by the current (existing) base tariff rates and the appropriate Purchased Gas Adjustment rate to produce the attrition period gas sales revenues at current rates.

[31] CGC's Updated Response to TPUC's Workbook Request, Schedule 3 (August 28, 2018).
[32] Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule7 (August 24, 2018).

CGC used the twelve months ended June 30, 2017 as its test period, forecasting gas sales revenues through its chosen attrition period, the twelve months ending June 30, 2019. The Company's Witness Heath Brooks testified that the weather normalization adjustment is computed by using a multi-linear regression methodology[33] to determine heating degree days and then another regression analysis to compute the appropriate WNA formula factors. Annualized customer usage and customer growth for the homogenous residential and commercial customer classes is based on consumption equations, using a multi-step process. Mr. Brooks uses a residential growth factor of 1.27% and a commercial growth factor of 0.46%. Other customer classes are analyzed based on a customer's foreseeable usage and demand requirements through the attrition period.[34] The Company then multiplies the forecasted attrition period billing determinants by the current tariff rates to arrive at its gas sales revenue forecast.[35]

The Consumer Advocate elected to use the twelve months ended December 31, 2017 as its test period, citing the fact that it contains more recent information than the test period used by the Company. The Consumer Advocate then forecasts gas sales revenues through its attrition period, the twelve months ending December 31, 2019. Consumer Advocate Witness William Novak uses a simple linear regression calculation of heating degree days to sales per bill to normalize usage.[36] Mr. Novak testified that this is the same weather normalization methodology historically adopted by this Commission in prior rate cases.[37] Mr. Novak used this same methodology to compute the proposed WNA formula factors. Mr. Novak computed customer growth for the residential and commercial classes by calculating the 2-year historical average of

[33] This methodology uses the Company's proprietary software program Forecast Pro.
[34] Heath J. Brooks, Pre-filed Direct Testimony, p. 3 (February 15, 2018).
[35] *Id.* at 4-5.
[36] Normal weather is determined based on a thirty (30) year average. The Consumer Advocate uses the 30-year period ended December 31, 2017, the end of its test period.
[37] William H. Novak, Pre-filed Direct Testimony, p. 8 (July 3, 2018).

added customers. For industrial customers, Mr. Novak utilized the test period numbers as representative of the attrition period. Customer usage for the residential and commercial classes were normalized, while industrial customer sales volumes were individually analyzed. Mr. Novak then multiplies his forecasted attrition period billing determinants by the current tariff rates to arrive at his gas sales revenue forecast. [38]

After reviewing the record and parties' calculations, the panel applied its adopted test period of the twelve months ended December 31, 2017 and the twelve months ending June 30, 2019 for the forward looking attrition period. Further, the panel adopted the average normalized usage per customer as calculated by the Consumer Advocate for the residential and commercial classes and the Consumer Advocate's individual customer analysis of forecasted usage for the industrial customers, finding both to be reasonable, particularly since the factors were based on historical data.

In addition, the panel found that the weather normalization adjustment methodology utilized by the Consumer Advocate is the more appropriate methodology, as it is a simple regression that is straight forward and can be easily replicated and is a methodology that has been historically adopted and utilized by the Commission. The WNA methodology utilized by CGC consists of a multi-step regression analysis using proprietary software that cannot be verified or recomputed without use of the software.

The voting panel voted unanimously to terminate the Alignment and Usage Mechanism (AUA) as recommended by the parties and to reinstate the Weather Normalization Adjustment (WNA) for the R-1 and C-1 rate classes, consistent with the simple regression methodology proposed by the Consumer Advocate and adjusted for the attrition period ending June 30, 2019. Thereafter, the panel voted unanimously to adopt attrition period Gas Sales Revenues of

[38] *Id.* at 10-11. *See also* Willian H. Novak Revenue Workpapers.

$70,473,655. The panel arrived at $70,473,655 based on the sum of amounts it unanimously adopted for:

Residential Revenues	$34,303,189;
Multi-Family Housing Revenues	$ 66,956;
Commercial C-1 Revenues	$ 7,594,595;
Commercial C-2 Revenues	$20,503,715;
Industrial F-1/T-2 Revenues	$ 3,085,648;
Industrial I-1 Revenues	$ 185,059;
Industrial T-1 Revenues	$ 1,082,153;
Industrial T-1/T-2 Revenues	$ 1,709,871;
Industrial T-3 Revenues	$ 1,800,158; and,
Special Contract Revenues	$ 142,310.

B(2). OTHER REVENUES

Other Revenues is a category consisting primarily of forfeited discounts and miscellaneous service charges. CGC forecasts Other Revenues based upon its budget and historical trends, resulting in a total of $612,767 for the attrition period.[39] The Consumer Advocate used a historical four year average as its forecast, resulting in an attrition period amount of $675,121.[40]

The panel found that the use of an historical four year average is a reasonable methodology for calculation of Other Revenues, as it uses known amounts as its basis as opposed estimated amounts. Thereafter the panel unanimously voted to adopt $675,121 for attrition period Other Revenues.

B(3). ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION

Allowance for Funds Used during Construction ("AFUDC") is a component of construction costs representing the net cost of funds borrowed and a reasonable return on those funds used during construction. The calculation of AFUDC is a function of the forecasted

[39] Heath J. Brooks, Pre-filed Direct Testimony, pp. 13-14 and Workpapers, (February 15, 2018).
[40] William H. Novak, Pre-filed Direct Testimony, p. 11, (July 3, 2018).

balance of Construction Work in Progress ("CWIP") for the attrition period multiplied by the proposed weighted average cost of capital for the attrition period.

CGC estimated AFUDC by multiplying its forecasted balance of CWIP for the attrition period by the Company's proposed weighted average cost of capital for the attrition period.[41] The Consumer Advocate forecasted AFUDC using a five year average of AFUDC from 2013 to 2018.[42]

The panel applied its determined weighted cost of capital of 7.12% to its calculated thirteen month average direct CWIP balance of $11,576,245, exclusive of allocated CWIP of $881,194. Therefore, the panel unanimously adopted $823,951 for Allowance for Funds Used During Construction for the attrition period.

B(4). Cost of Gas

Since Gas Costs are recovered through the Purchased Gas Adjustment mechanism, they are not included in the calculation of the Revenue Requirement. It is therefore necessary to deduct the computed cost of gas sales projected for the attrition period from Total Revenues to arrive at Total Operating Margin.

CGC used the wholesale futures price of natural gas as reported by NYMEX on January 3, 2018 as the basis to project an attrition period PGA rate, and using a regression equation developed with historical NYMEX prices and historical CGC retail prices. This rate is then applied to the attrition period billing determinants.[43] The Consumer Advocate prices out gas costs by multiplying its attrition period billing determinants by CGC's approved December 31, 2017 PGA tariff rate.[44]

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[41] Gary Tucker, Pre-filed Direct Testimony, p. 6 (May 11, 2018).
[42] Transcript of Hearing, Vol. III A, pp. 29-30 (August 22, 2018).
[43] Heath J. Brooks, Pre-filed Direct Testimony, p. 14 (February 15, 2018).
[44] William H. Novak, Pre-filed Direct Testimony, pp. 11-12 (July 3, 2018).

The panel found that the preferred methodology is to use an actual PGA tariff rate to project PGA gas costs. In this case, the panel utilized the PGA tariff rate submitted by CGC which became effective July 1, 2018. As a result, the attrition period gas cost amount adopted unanimously by the panel was $38,611,525.

B(5). TOTAL OPERATING MARGIN

Thereafter, the panel voted unanimously to adopt a Total Operating Margin of $33,361,202 for the attrition period. The panel arrived at the sum of the amounts it adopted for the Base Revenues in the amount of $70,473,655, Other Revenues in the amount of $675,121, and AFUDC in the amount of $823,951, less the Cost of Gas in the amount of $38,611,525.

C. OPERATIONAL AND MAINTENANCE EXPENSES

Operational and Maintenance ("O&M") Expenses are comprised of expenses associated with services necessary to run the business operations of CGC. The majority of these expenses are variable and dependent upon items such as the number of customers and employees, revenues, assets, etc. CGC budgets an annual total of $13,453,586 for O&M expenses[45] while the Consumer Advocate forecasts $10,964,177[46] – a difference of $2,489,409. The main differences between the Company and the Consumer Advocate relate to payroll expense and allocated expenses from CGC's parent company, Atlanta Gas and Light ("AGL").

The panel unanimously voted to adopt annual O&M expenses of $11,478,640 for the attrition period. Below is a table summarizing the O&M attrition period and O&M Expenses as advocated by CGC and the Consumer Advocate and as adopted by the Commission panel. Following the table is a discussion of each expense component.

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[45] CGC's Updated Response to TPUC's Workbook Request, Schedule 4 (August 28, 2018).
[46] Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule 9 (August 24, 2018).

O&M Expenses			
	CGC	Consumer Advocate	Commission Panel
	Attrition Year End 6/30/19	Attrition Year End 12/31/19	Attrition Year End 6/30/19
Payroll expense	$3,525,350	$2,983,448	$3,216,717
Employee Benefits	632,861	728,437	716,680
Benefits Capitalized	(59,357)	(103,075)	(92,484)
Fleet Services & Facilities Expense	728,185	822,931	810,419
Outside Services	2,087,933	1,878,336	1,849,778
Other Distribution & Storage Expense	804,148	597,294	588,213
Bad Debt Expense	127,970	121,863	121,863
Sales Promotion Expense	71,891	52,574	0
Customer Service & Account Expense	6,482	4,831	4,859
Administration & General Expense	712,523	829,853	951,611
Admin. & Gen. Salaries Exp. Capitalized	(66,719)	(69,690)	(60,878)
AGL Service Company Allocations	4,822,218	3,117,375	3,371,863
Total	**$13,453,585**	**$10,964,177**	**$11,478,640**

C(1). PAYROLL EXPENSE

The Company based its payroll expense upon its 2018 budget which includes the anticipated hiring of ten new employees. This increase from forty to fifty employees represents a 25% increase over existing employee levels.[47] The payroll expense for these budgeted fifty employees multiplied by the average annual merit increase of 3% yields the attrition year payroll expense of $3,525,350.[48] Wendell David testified that, "these new employees are very necessary to improve the operational integrity and safety of our new systems due to new regulations, better training, system expansions and growth, and improved customer services and responsiveness".[49]

The Consumer Advocate based its payroll expense on the actual dollar amount for payroll expense for the twelve months ending December 31, 2017, adjusted by removing the amount of

[47] *Chattanooga Gas Company Responses and Objections to Consumer Advocate First Discovery Requests*, Response No. 1-122, (April 10, 2018). *See also* Transcript of Hearing, Vol. I A, p. 50, Hearing Exhibit 2 (August 20, 2018).
[48] Gary Tucker, Pre-filed Direct Testimony, pg. 8 (May, 11, 2018).
[49] Wendell Dallas, Pre-filed Rebuttal Testimony, p. 14 (August 3, 2018).

allocated Annual Incentive Performance Pay associated with direct CGC's labor cost.[50] The Consumer Advocate then utilized a compounded growth rate of 7.25%, based upon a two year average in labor costs growth, to calculate attrition year payroll expense of $2,983,448.[51] The Consumer Advocate disagrees with the Company's assumption that it will increase its Tennessee-Based employee count by 25% between the Test Period and Attrition Period. Mr. Dittemore testified, "[h]istory suggests the 25% increase in CGG labor is an unrealistic assumption and one that appears to be an attempt to increase the revenue requirement without any real substance."[52] As a result, the Consumer Advocate maintained the employee count from the test year of 39 through the attrition year.

The panel found that CGC consistently over-budgeted the number of employees between 2008 and 2017, having between 37 and 42 employees during that time period.[53] Upon cross examination during the hearing, Mr. Dallas confirmed that the budgeted number of employees was never achieved for 2017 and that the number of employees fluctuates throughout the year such that the Company can be three to five employees under budget at a given time.[54] The Company's approach is based upon an assumption that new hires will be in place prior to the position becoming vacant,[55] while the Company being under the budgeted number of employees may be due to new hires coming in only after a position becomes vacant. While CGC charges that the Consumer Advocate's approach "has no basis in fact or reality,"[56] it is the Company's approach that appears to be based mostly on assumptions. Therefore, while the panel found that,

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[50] David Dittemore, Pre-filed Direct Testimony, p. 6, (July 3, 2018).
[51] Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule 9, Consumer Advocate Workpaper, Attachment DD 9-1, (August 24, 2018).
[52] David Dittemore, Pre-filed Direct Testimony, p. 15, (July 3, 2018).
[53] *Chattanooga Gas Company Responses and Objections to Consumer Advocate First Discovery Requests*, Response No. 1-135, (April 10, 2018).
[54] Transcript of Hearing, Volume I A, pp. 51-52, (August 20, 2018).
[55] Wendell Dallas, Pre-filed Direct Testimony, p. 13, (February 15, 2018).
[56] *Post-Hearing Brief of Chattanooga Gas Company*, p. 19 (September 10, 2018).

as the Consumer Advocate asserts, it is highly unlikely the Company will increase its employee count to 50 in the attrition period, especially based on the historical employee levels. Nevertheless, the panel found that it is reasonable to expect the employee count to increase during the attrition period.

Based upon CGC's response to the Consumer Advocate Data Request No. 1-135, the Company had 39 employees in June 2017[57] and Mr. Dallas' testimony at the Hearing confirmed that Chattanooga Gas had approximately 42 employees throughout 2017.[58] Utilizing an eighteen month Compounded Salary and Wage Rate Change Factor of 5.388%, calculated based upon the CGC's response to the Consumer Advocate's Discovery Request 1-345,[59] the panel applied this factor to the test period employee count of 42 to arrive at an attrition period employee count of 44.

CGC and the Consumer Advocate also differed on how incentive compensation was treated in their calculations. The term "incentive compensation" is also referred to as "at-risk compensation."[60] James Garvie testified on behalf of CGC that employee fixed salaries are based upon the median of the market and the incentive portion is the compensation that is at-risk contingent upon meeting pre-determined targets.[61] CGC reiterates in its Post-Hearing Brief that base salaries are set at 50% of the market and that the compensation structure should be considered in the context of the present day labor market, in which most successful businesses offer a compensation program that includes at-risk pay.[62] The Consumer Advocate adjusted its

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[57] *Chattanooga Gas Company Responses and Objections to Consumer Advocate First Discovery Requests*, Response No. 1-135, (April 10, 2018).
[58] Transcript of Hearing, Vol. 1 A, pg. 52 (August 20, 2018).
[59] *Chattanooga Gas Company Responses and Objections to Consumer Advocate Supplement to First Discovery Requests*, Response No. 1-345, (April 20, 2018).
[60] Transcript of Hearing, Vol. 1 A, pg. 12 (August 20, 2018).
[61] James Garvie, Pre-filed Rebuttal Testimony, pp. 6-10, (August 3, 2018). *See also* Transcript of Hearing, Vol. III A, pp. 8-10 (August 22, 2018).
[62] *Post-Hearing Brief of Chattanooga Gas Company*, p. 10 (September 10, 2018).

attrition forecast of payroll expense to remove $228,786 of incentive compensation, asserting that such "payouts are driven by corporate and business unit financial performance that directly benefits The Southern Company shareholders and therefore such costs should not be borne by CGC ratepayers."[63]

The panel found the Consumer Advocate's 2019 forecasted incentive pay exclusion to be reasonable, grounded upon historical operations and consistent with the long-standing policy established by the Commission regarding incentive pay. Moreover, the Company provided no convincing evidence justifying its deviation from established Commission policy. In addition, as Consumer Advocate witness Dittemore testified[64] and CGC witness Garvie acquiesced,[65] short-term incentive compensation is partially paid out based upon enhancing the earnings per share ("EPS") of the Southern Company stock price. CGC and the Consumer Advocate agreed that while ratepayers may benefit from efficiency, stockholders will also benefit from increased EPS. The panel found the compensation to be fair, with annual merit increases through the attrition period. For the foregoing reasons, the panel unanimously voted to disallow 50% of the short term incentive compensation.

The panel voted unanimously to adopt a payroll expense of $3,216,717 for the twelve month attrition period ending June 30, 2019. The panel arrived at this amount applying its findings on CGC payroll expense, beginning with the test period (twelve months ending December 31, 2017) payroll expense, removing 50% of the short term incentive compensation to arrive at an adjusted test period payroll, calculating the average employee pay using the December 31, 2017 employee count, and then multiplying the average employee pay by the

[63] David Dittemore, Pre-filed Direct Testimony, p. 7, (July 3, 2018).
[64] *Id.* at 7-8.
[65] Transcript of Hearing, Vol. III A, p. 11, (August 22, 2018).

attrition period employee count. Utilizing this calculation, the panel arrived at the adopted payroll expense of $3,216,717.

C(2). EMPLOYEE BENEFITS

Employee benefits includes the costs associated with 401(k) benefits, group health benefits, pension expense, and post-retirement benefits other than pensions. CGC based its employee benefit expense upon its 2018 budget to achieve attrition year employee benefit expense of $632,861. The 401(k) costs were based on the 2018 budget and increased by the average annual merit increase of 3%. Group health and other benefits were based upon data collected relative to medical, prescription drug and behavioral health claims. According to Mr. Tucker, changes to enrollment, plan changes and administrative costs were also considered in developing the attrition period estimate. The post retirement and pension expense was based upon an estimate from the Company's actuary. [66]

The Consumer Advocate based its employee benefits expense on the actual amount of $728,437 for the twelve months ending December 31, 2017.[67] Mr. Dittemore testified that this amount was adjusted by removing accrued pension and Other Post-Employment Benefits ("OPEB") and capitalized pensions, and cash pension contributions were added[68] for a total negative adjustment of $66,775.[69] The resulting amount was then multiplied by the compounded growth factor of 7.25% to arrive at employee benefits expense of $728,437.[70]

The panel found that, based upon review of budgeting process documents provided by CGC, employee benefits are budgeted by the Human Resource Department and no benefits are

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[66] Gary Tucker, Pre-filed Direct Testimony, pp. 8-9, (May 11, 2018).
[67] David Dittemore, Pre-filed Direct Testimony, p. 5, (July 3, 2018).
[68] Consumer Advocate Data Request 1-308 only identified cash contributions to the pension plan and none to its OPEB plan.
[69] David Dittemore, Pre-filed Direct Testimony, p. 8, (July 3, 2018).
[70] Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule 9, (August 24, 2018).

budgeted for incremental employees. Further, the panel found that the budgeting process makes no mention of the Company comparing its forecasted budget to the latest actual 12 months to identify any abnormalities or the reasonableness of the budgeted amounts or that CGC will no longer pay Dental and Vision Premiums.

Based upon a review of the actuarial report cited by the Company, the panel found that there is no required contribution amount provided in the report. Therefore, the panel found CGC's assertion that pension expense was based upon the actuarial report to be unsubstantiated. Further, CGC makes no argument that the cash approach utilized by the Consumer Advocate is incorrect; but rather argues the GAAP method "makes better sense."[71]

Based upon analysis of the evidence, the panel voted unanimously to adopt employee benefits expense for the twelve month attrition period ending June 30, 2019 of $716,680. The panel arrived at that amount for employee benefits expense based upon the December 31, 2017 test period with the recommended adjustments of ($66,775) as described by the Consumer Advocate, and removal of Dental and Vision Premiums, for a total of $688,801. The panel then grew this amount to the projected 44 employees and applied the compounded composite growth factor of 3.7% to arrive at the adopted $716, 680 for the attrition year.

C(3). BENEFITS CAPITALIZED

As with other O&M expenses, the Company forecasted its attrition period Benefits Capitalized of ($59,257) as the budgeted amount for the calendar year 2018 and then grew that amount through the attrition period ending June 30, 2019.[72] The Consumer Advocate applied a

[71] *Post-Hearing Brief of Chattanooga Gas Company*, p. 13 (September 10, 2018).
[72] CGC's Updated Response to TPUCs Workbook Request, Schedule 4, (August 28, 2018).

compounded growth rate of 5.3% to the test period amount of ($97,884) to arrive at ($103,075) for benefits capitalized.[73]

The panel found that it could accept neither of the expense figures asserted by the parties, as the attrition year adopted by the panel is forecasting fewer employees than CGC and more employees than the Consumer Advocate. Therefore, the panel calculated a percentage of benefits capitalized using the December 31, 2017 test period amount of benefits expensed plus the benefits capitalized in total to the benefits capitalized and subsequently grossed up employee benefit expense by the inverse to arrive at a total employee benefit amount for the attrition year ending December 31, 2019. The benefits capitalized percentage was applied to the total employee benefit amount $809,164 to arrive at employee benefits capitalized of ($92,484). Therefore, the panel voted unanimously to adopt an operation and maintenance expense of Benefits Capitalized of ($92,484) for the attrition year ending December 31, 2019.

C(4). Fleet Services and Facilities, Outside Services, Other Distribution and Storage

The Company based its fleet services, facilities, outside services and other distribution expense upon the 2018 budget to achieve attrition year expense of $728,185 for fleet services, $2,087,933 for outside services and $804,148 for other distribution and storage expense.[74] According to Mr. Tucker all of these expenses were forecasted for the 2018 year and increased by a monthly average CPI percentage of 3% for six months through the end of the attrition period.[75]

The Consumer Advocate arrived at attrition period expenses of $822,931 for fleet services, $1,878,336 for outside services and $597,294 for other distribution and storage

[73] Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule 9, Consumer Advocate Workpaper, Attachment DD 9-3, (August 24, 2018).
[74] CGC's Updated Response to TPUCs Workbook Request, Schedule 4, (August 28, 2018).
[75] Gary Tucker, Pre-filed Direct Testimony, p. 9, (May 11, 2018).

expenses by utilizing the actual amounts per the trial balance at December 31, 2017.[76] Using these beginning balances, the Consumer Advocate applied an average two year compounded annual growth factor of 5.30% based on the CPI for 2018 and 2019.[77]

The panel found that CGC's budget process fails to compare the forecasted budget to the latest actual 12 months ending to identify any abnormalities between historical expenditures and budgeted upcoming expenditures. Further, the panel found that expenses should be aligned with the operations of the Company and should trend with previous expenditures and therefore, should be based upon historical amounts rather than a forecast which is not based on a realistic foundation. The panel also noted the different starting point used by the Company and the Consumer Advocate as the basis to determine the attrition period amounts.

Based upon calculations utilizing the actual test period amounts at December 31, 2017 and growing them by a compounded growth factor of 3.7%, the panel arrived at balances for the attrition period ending June 30, 2019 for Fleet Services and Facilities of $810,419, Outside Services of $1,849,778 and Other Distribution and Storage of $588,213. The panel unanimously voted to adopt operation and maintenance expenses for the attrition year ending June 30, 2019 for the following categories: Fleet Services and Facilities, $810,419; Outside Services, $1,849,778; and, Other Distribution and Storage, $588,213.

C(5). BAD DEBT (UNCOLLECTIBLE EXPENSE)

The Company forecasted $127,970 for bad debt expense by taking its projected December 31, 2018 budget and increasing the amount by monthly average CPI percentages[78]

[76] Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule 9, (August 24, 2018).
[77] David Dittemore, Pre-filed Direct Testimony, p. 14, (July 3, 2018). *See also* Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule 9, (August 24, 2018).
[78] CGC's Updated Response to TPUCs Workbook Request, Schedule 4, (August 28, 2018).

from the end of test period through the end of the attrition period.[79] In its Post-Hearing Brief the Company states this expense is partially based upon its proposed rate increase.[80] The Consumer Advocate took an actual five year average (2013-2017) of uncollectible expense of $100,904 and added an actual five year average of uncollectible expense-damages of $20,958 to arrive at an attrition period bad debt expense of $121,863.[81]

The panel found that the use of actual data for determining bad debt expense rather than forecasted budget based in part on a requested rate increase is reflective of the widely accepted policy of the Commission of historical forecasting which is grounded on actual results. Therefore, the panel found the Consumer Advocate's amount for bad debt expense to be reasonable. The panel voted unanimously to adopt the amount of $121,863 as bad debt expense for the attrition period ending June 30, 2019.

C(6). SALES PROMOTION

The Company forecasted $71,891 for sales promotion expenses.[82] This amount was calculated by taking CGC's forecasted 2018 budget for sales promotion expense and growing the amount by a CPI index to arrive at an amount for attrition period ending June 30, 2019.[83] The Consumer Advocate calculated sales promotion expense by taking the amount of such expense on CGC's December 31, 2017 trial balance of $51,996 and applying a growth factor derived from the growth in labor costs from 2015-2017. The Consumer Advocate arrived at a resulting sales promotion expense is $52,574 for the attrition period ending December 31, 2019.[84]

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[79] Gary Tucker, Pre-filed Direct Testimony, p. 10, (May 11, 2018).
[80] *Post-Hearing Brief of Chattanooga Gas Company*, p. 34, (September 10, 2018).
[81] Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule 9, (August 24, 2018).
[82] CGC's Updated Response to TPUCs Workbook Request, Schedule 4, (August 28, 2018).
[83] Gary Tucker, Pre-filed Direct Testimony, p. 9, (May 11, 2018).
[84] Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule 9, Consumer Advocate Workpaper, Attachment DD 9-6, (August 24, 2018).

While both parties include sales promotion as recoverable expenses, the panel found that Commission Rule 1220-04-05.45 on Advertising applied to this expense. The Rule provides:

> 1220-04-05-.45 ADVERTISING.
>
> (1) A utility may not recover from any person other than their shareholders (or other owners) any direct or indirect expenditure for promotional or political advertising.
> (a) The term "advertising" means the commercial use of any media, including newspaper, printed matter, radio, and television, in order to transmit a message to a substantial number of members of the public or to gas customers.
> (b) The term "political advertising" means any advertising for the purpose of influencing public opinion with respect to legislative, administrative, or electoral matters, or with respect to any controversial issue of public importance.
> (c) The term "promotional advertising" means any advertising for the purpose of encouraging any person to select or use gas service or additional gas service or the selection or installation of any appliance or equipment designed to use gas service.
> (d) The terms "political advertising" and "promotional advertising" do not include:
>
> 1. Advertising which informs gas customers how they can conserve energy or can reduce peak demand for gas;
> 2. Advertising required by law or regulation, including advertising required under Part 1 of Title II of the National Energy Conservation Policy Act;
> 3. Advertising regarding service interruptions, safety measures or emergency conditions;
> 4. Advertising concerning employment opportunities;
> 5. Advertising which promotes the use of energy efficient appliances, equipment, services, or which informs customers that natural gas is cheaper and/or more efficient than other fuels; or
> 6. Any explanation or justification of existing or proposed rate schedules or notification of hearings thereon.

Upon review and verification of the Uniform System of Accounts ("USOA") in which CGC's sales promotion was accounted booked, the panel found the accounts to be clearly defined in USOA as advertising and activities promoting sales. Therefore, based upon Commission rules that clearly prohibit expenses related to sales activities from being recovered

in consumer rates, the panel voted to exclude sales promotion expense from attrition period expenses.

C(7). CUSTOMER SERVICE AND ACCOUNT

CGC forecasted $6,482 for the attrition period ending June 30, 2019 utilizing the Company's forecasted budget and grown by the annual CPI growth factor to arrive at an amount for June 30, 2019 attrition period.[85] The Consumer Advocate took the December 31, 2017 ending trial balance amount of $4,775 and applied a customer related growth factor, arriving at a resulting customer service and account promotion expense of $4,831 for the attrition period.[86]

The panel found that the use of historical data as a starting point for calculations provides more credibility and verifiable evidence than the use of budgeted amounts for the attrition period. However, upon review of the Consumer Advocate's calculation for customer service and account expense, the panel found that the growth factor applied by the Consumer Advocate was not compounded for the correct growth time frame. Applying the compounded customer growth factor of 1.76% to the test period amount of $4,775 yields an attrition period expense of $4,859. Accordingly, the panel voted unanimously to adopt $4,859 in customer service and account expense for the attrition period ending June 30, 2019.

C(8). ADMINISTRATIVE AND GENERAL

According to Mr. Tucker, administrative and general expenses were forecasted by taking the 2018 budget amounts and increasing them by monthly average CPI percentages from the end of test period through the end of the attrition period.[87] To this amount, the Company added an annual deferred rate case amortization expense of $248,333 ($1,241,665 in total rate case

[85] Gary Tucker, Pre-filed Direct Testimony, p. 9, (May 11, 2018); CGC's Updated Response to TPUCs Workbook Request, Schedule 4, (August 28, 2018).
[86] Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule 9, Consumer Advocate Workpaper, Attachment DD 9-7, (August 24, 2018).
[87] Gary Tucker, Pre-filed Direct Testimony, p. 9, (May 11, 2018).

expenses amortized over a five year period). In total, the Company forecasted $712,523 for administrative and general expenses for the attrition period.[88] CGC urges that its rate case expenses are just and reasonable and presented testimony from Mr. Dallas, Mr. Hickerson, Mr. Yardley and Mr. Tucker concerning the prudency and necessity of the expenses.[89] Mr. Dallas testified that the filing of the case was delayed because of the passage of the Tax and Jobs Act in December of 2017 which caused CGC to redo its case due to reduction in corporate tax rates.[90]

The Consumer Advocate took the actual amount of administrative and general expenses per the trial balance at December 31, 2017 and applied an average two year compounded growth factor of 5.30% based on the CPI for 2018 and 2019 to calculate its attrition period amount.[91] The Consumer Advocate then added an annual deferred rate case amortization expense of $115,718, which is calculated by taking the Consumer Advocate's recommended total rate case expense of $347,153 and amortizing it over three years.[92] The difference in the rate case expense is due to the Consumer Advocate eliminating the recovery of consultant costs related to the class cost of service study, which Mr. Novak testified has never been accepted by Commission, nor on which has the Commission set utility rates.[93] The Consumer Advocate stated the legal expenses to prepare and try the case were much higher than anticipated and "seemed duplicative and imprudent."[94] Therefore, the Consumer Advocate eliminated one-half the estimated legal

[88] CGC's Updated Response to TPUCs Workbook Request, Schedule 4, (August 28, 2018).
[89] *Post-Hearing Brief of Chattanooga Gas Company*, p. 14, (September 10, 2018).
[90] Wendell Dallas, Pre-filed Rebuttal Testimony, p. 3, (August 3, 2018); *See also* Gary Tucker, Pre-filed Rebuttal Testimony, p. 5, (August 3, 2018).
[91] Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule 9, Consumer Advocate Workpaper, Attachments DD 9-8 and 10-2, (August 24, 2018).
[92] *Id.*
[93] William H. Novak, Pre-filed Direct Testimony, p. 24, (July 3, 2018); Transcript of Hearing, Vol. III A, p. 32, (August 22, 2018). *See also Consumer Advocate's Post-Hearing Brief*, p. 28-29 (September 10, 2018).
[94] *Id.*

expenses from recovery in rates. The Consumer Advocate's resulting calculation of administrative and general expenses for the attrition period is $829,853.[95]

As discussed more fully in section J(4) herein below, the panel notes its concern regarding the high level of rate case expenses, acknowledging the benefit that both ratepayers and stockholders receive from the rate increases that generally follow the completion of rate cases. The panel found that in this case, the documentation and evidentiary record are not sufficiently detailed to determine a reasonable apportionment of rate case expense between ratepayers and shareholders based on their relative benefits from the proceeding. Without such proof, the panel determined that exclusion of a percentage or specific amount of rate case expense would be unsupported and potentially arbitrary. Accordingly, the panel found CGC's proposed rate expenses and proposed five-year amortization to be reasonable and acceptable.

The panel arrived at total administrative and general expenses of $951,611 for the twelve month attrition period ending June 30, 2019. This amount is calculated by taking the December 31, 2017 trial balance of administrative and general expenses and growing that amount by a composite 3.7% growth factor, and then adding $248,333 of amortized of rate case expenses. The panel voted unanimously to adopt $951,611 in administrative and general expenses for the attrition period.

C(9). Administrative & General Salaries (Payroll) Capitalized

Consistent with other O&M expenses, CGC forecasted its attrition period administrative and general salaries capitalized of ($66,719) as the budgeted amount for the calendar year 2018, grown to the attrition period ending June 30, 2019.[96] The Consumer Advocate applied a

[95] Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule 9, Consumer Advocate Workpaper, Attachment DD 9-8, (August 24, 2018).
[96] CGC's Updated Response to TPUCs Workbook Request, Schedule 4, (August 28, 2018); Gary Tucker, Pre-filed Direct Testimony, p. 9, (May 11, 2018).

compounded growth rate of 5.3% to the December 31, 2017 test period amount of ($66,180) to arrive at ($69,690) for administrative and general salaries capitalized.[97]

Since the panel previously found that 44 employees are adopted for the attrition period, which is fewer employees than the Company and more employees than Consumer Advocate, it found that it could not accept the recommendation of either party. A percentage of payroll expense capitalized was calculated using CGC's forecasted payroll capitalized as a percentage of total payroll expense. The panel applied this percentage to the adopted payroll expense to arrive at administrative and general salaries capitalized of ($60,878). The panel voted unanimously to adopt the Administrative and General Salaries Capitalized of ($60,878) for the attrition period.

C(10). AGL Service Company Allocations

CGC forecasts attrition year allocations attributed to AGL Services of $4,882,218.[98] The Company allocated AGL services pursuant to the allocation methodology contained in the service agreement between the companies.[99] Mr. Morley testified that CGC began using this methodology in 2000 and included AGL cost allocations in Tennessee rate proceedings in 2004, 2006 and 2009 as well as in proceedings in five other states.[100]

Mr. Dittemore provided testimony expressing concern with the "significant lack of transparency and documented processes supporting the cost allocation methodology that I would expect from a very large regulated entity such as The Southern Company."[101] Mr. Dittemore further testified regarding the Consumer Advocate's recommendation that the Commission

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[97] Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule 9, Consumer Advocate Workpaper, Attachment DD 9-9, (August 24, 2018); David Dittemore, Pre-filed Direct Testimony, p. 14, (July 3, 2018).
[98] CGC's Updated Response to TPUCs Workbook Request, Schedule 4, (August 28, 2018).
[99] Michael J. Morley, Pre-filed Rebuttal Testimony, pp. 15-16, (August 3, 2018).
[100] *Id.* at 12-13; *Post-Hearing Brief of Chattanooga Gas Company*, p. 14, (September 10, 2018).
[101] David Dittemore, Pre-filed Direct Testimony, p. 31, (July 3, 2018).

require future filings to be fully supported with a Cost Allocation Manual ("CAM") to determine corporate allocations.[102]

Absent a CAM, the Consumer Advocate uses the Company's 2017 year end amount for allocations of $4,457,091 and adjusts the test year amount by removing $1,316 of benefits, $1,139,788 of short-term and long-term incentive compensation, $273,467 of lobbying expense, and $82,136 in corporate allocated expense.[103] This adjusted test year amount of $2,960,385 is then grown using a compound attrition factor of 5.30% to arrive at $3,117,375. The Consumer Advocate's forecasted amount is $1,764,843 less than that of the Company.[104]

The Consumer Advocate argues that because there is no direct Long-Term Incentive Compensation paid by Chattanooga Gas, a significant portion of the Short Term Incentive Compensation is driven by the corporate and business unit performance, directly benefiting The Southern Company. Therefore, The Consumer Advocate asserts these costs should not be recovered from CGC ratepayers.[105] The Consumer Advocate questioned Mr. Dallas about why CGC ratepayers should pay him a bonus when the earnings per share of the Southern Company go up, but Mr. Dallas gave no response.[106]

The panel noted that while CGC argues it has been utilizing a consistent methodology since 2000, the Company fails to address the fact that The Southern Company acquired AGL in July 2016.[107] Therefore, a different Company is allocating cost. The panel also noted that the majority of the $1,764,843 difference between the Company and the Consumer Advocate for the

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[102] *Id.* at 31-32.
[103] *Id.* at 8-14; Transcript of Hearing, Vol. III A, pp. 51-52, (August 22, 2018); Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule 9, Consumer Advocate Workpaper, Attachment DD 9-11, (August 24, 2018).
[104] Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule 9, Consumer Advocate Workpaper, Attachment DD 9-11, (August 24, 2018).
[105] *Consumer Advocate's Post-Hearing Brief*, p. 40, (September 10, 2018).
[106] Transcript of Hearing, Vol. I A, p. 74-75, (August 20, 2018).
[107] Wendell Dallas, Pre-filed Direct Testimony, p. 14, (May 11. 2018).

attrition period relates to the adjustments made by the Consumer Advocate to remove Bonuses, Short and Long Term Incentives, Allocated Supplemental Executive Retirement Plan expenses ("SERP"), Government Relations, Legal and Lobbying Expenses totaling $1,496,707.

The panel found that that removal of expenses related to SERP, lobbying expense, certain pension benefits, and organization dues, as recommended by the Consumer Advocate, is reasonable and consistent with previous rulings of the Commission. The panel removed said expenses from the trial balance test period amount as of December 31, 2017, and then removed 50% of short-term incentive compensation and 100% of long-term incentive compensation (consistent with the methodology used for payroll expense and pursuant to established Commission precedent for recovery of incentive compensation) and applied a customer growth factor of 3.7%. This calculation results in $3,371,863 of AGL allocated service expenses for the attrition period ending June 30, 2019, which the panel voted unanimously to adopt.

D. PURCHASED GAS EXPENSE

As discussed in section B(4) herein, the voting panel found that the preferred methodology to determine purchased gas expense is to use an actual PGA tariff rate to project PGA gas costs. Therefore, the panel unanimously adopted $38,611,525 in purchased gas expense for the attrition period based upon CGC's July 1, 2018 PGA tariff rate.

E. DEPRECIATION EXPENSE

Depreciation expense is discussed in the paragraphs herein below addressing Utility Plant in Service, Depreciation and Accumulated Depreciation. Accordingly, for the reasons set out more fully in the discussion in the subsequent section of this order, the panel unanimously voted to adopt depreciation expense of $8,035,649 for the attrition period ending June 30, 2019.

F. INTEREST ON CUSTOMER DEPOSITS

TPUC Rule 1220-4-5.14 allows gas utilities to accrue interest on Customer Deposits. Such interest is refunded to the customer along with the security deposit after a specified time period when the customer demonstrates credit-worthiness. CGC forecasted $96,740 for the attrition period Interest on Customer Deposits.[108] The Consumer Advocate forecasted $114,315 for the attrition period Interest on Customer Deposits.[109] The panel multiplied the adopted accrued interest on customer deposits by the tariffed interest rate of 6.0% per annum and arrived at the amount forecasted by the Company. Therefore, the panel voted unanimously to adopt $96,740 for Interest on Customer Deposits for the attrition year ending June 30, 2019.

G. TAXES OTHER THAN INCOME TAXES

G(1). PROPERTY TAX

The Company forecasted $1,975,518 for property tax by growing its 2018 budgeted amount by the Company's monthly average CPI percentages.[110] The Consumer Advocate started with actual property tax per book amounts for the twelve months ending December 31, 2017, and then reclassified $4,484 of allocated property tax to allocated taxes other than income. The Consumer Advocate then used a compound growth factor of 7.11% to arrive at attrition period property taxes of $2,039,886.[111]

As opposed to strictly using a budgeted amount as proposed by the Company, the panel found that historical amounts provide more credible evidence of future outcomes in this instance. For this reason, the panel determined a property tax percentage by comparing the Consumer

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[108] CGC's Updated Response to TPUCs Workbook Request, Schedule 3, (August 28, 2018).
[109] Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule 6, Consumer Advocate Rate Base Workpaper R-50-1.00, (August 24, 2018).
[110] CGC's Updated Response to TPUCs Workbook Request, Schedule 5, (August 28, 2018).
[111] Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule 10, Consumer Advocate Workpaper, Attachment DD 10-1, (August 24, 2018).

Advocate's December 31, 2017 test year amount for property tax with the Company's thirteen month average of the combined direct plant and allocated plant in service. The panel applied this percentage to the plant in service for the attrition period ending June 30, 2019 to arrive at property taxes of $2,093,447, which the panel voted unanimously to adopt.

G(2). COMMISSION INSPECTION FEE

The Company forecasted $315,074 for Commission inspection fees based on a 2018 budget amount grown by the Company's monthly average CPI percentages.[112] The Consumer Advocate forecasted $391,525 by applying a composite ratio of 5.30% to actual booked amounts for the twelve months ending December 31, 2017.[113]

The panel calculated Commission Inspection Fee by applying statutory rates set forth in Tenn. Code Ann. § 65-4-303. Consistent with statutory language, attrition period gas revenue, AFUDC, and Other Revenues less Uncollectibles were summed for a total of $71,850,864. This revenue amount was then reduced by the statutory $5,000 exemption to arrive at a taxable revenue base for inspection fees. The panel unanimously voted to adopt $305,345 for the attrition period ending June 30, 2019, having applied the statutory rate of 0.425% to the remaining balance to arrive at the adopted inspection fee.

G(3). PAYROLL TAXES

The Company forecasted $214,815 for the attrition period based on a 2018 budgeted amount increased by a 3% merit increase.[114] According to Mr. Tucker's rebuttal testimony, "the

[112] CGC's Updated Response to TPUCs Workbook Request, Schedule 5, (August 28, 2018).
[113] Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule 10, Consumer Advocate Workpaper, Attachment DD 10-1, (August 24, 2018).
[114] CGC's Updated Response to TPUCs Workbook Request, Schedule 5, (August 28, 2018).

forecast for 2019 should be based on the 2018 budget as this more closely aligns with the Company's planned business operations."[115]

The Consumer Advocate disagrees with the Company's assertion and based payroll taxes on the 2017 year end amount of $187,647. The Consumer Advocate then reclassified $144,265 to allocated taxes other than income. The Consumer Advocate forecasted the test year using a labor composite attrition factor of 7.25% to arrive at the total of $355,971 resulting in a $141,156 difference from the Company. [116]

The panel found that in this instance, the historical amounts provide more credible evidence of future outcomes than the budgetary data provided by the Company. For this reason, the panel calculated a percentage for payroll tax using the Consumer Advocate's test year booked payroll tax as a percentage of booked payroll expense. The panel applied this percentage to the difference between the adopted payroll expense and the booked test year payroll expense for a total of $46,135.66. This incremental payroll tax amount (payroll tax for additional payroll expense) was then added to the December 31, 2017 booked payroll tax amount to arrive at attrition period payroll taxes of $383,805. The panel thereafter voted unanimously to adopt $383,805 in payroll taxes for the attrition year ending June 30, 2019.

G(4). FRANCHISE TAX

CGC forecasted $409,287 for franchise tax based on a 2018 budget amount grown by the Company's monthly average CPI percentages.[117] The Consumer Advocate forecasted $141,050

[115] Gary Tucker, Pre-filed Rebuttal Testimony, p. 29, (August 3, 2018).
[116] Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule 10, Consumer Advocate Workpaper, Attachment DD 10-1, (August 24, 2018).
[117] CGC's Updated Response to TPUCs Workbook Request, Schedule 5, (August 28, 2018).

based on the Company's actual year end December 31, 2017 amount of $124,028 multiplied by a two year revenue growth factor of 13.72%.[118]

The panel found that the Company provided no documentation of how it calculated budgeted Franchise Taxes other than a budgeted total. Based on the absence of documentation indicating reliability of the Company's amount, the panel determined it more reasonable and prudent to base its forecast on historical data utilized by the Consumer Advocate. Accordingly, the panel calculated a Franchise Fee percentage based upon the Company's thirteen month average of the combined direct plant and allocated plant in service to Consumer Advocate's test period Franchise Tax. The panel applied this percentage to the adopted Plant in Service to determine the Franchise Tax. The panel unanimously adopted Franchise Tax in the amount of $136,334 for the attrition period ending June 30, 2019.

G(5). GROSS RECEIPT TAX

The Company forecasted $451,841 of gross receipt tax for the attrition year ending June 30, 2019 based upon its budgeted amounts multiplied by monthly average CPI percentages.[119] The Consumer Advocate forecasted gross receipt taxes of $904,986 for the attrition year end December 31, 2019, utilizing the actual year end December 31, 2017 booked amount and applying a 13.72% revenue growth factor.[120]

The panel found that use of historical amounts provides more credible evidence of future outcomes than budgetary data in this instance. Based upon this finding, the panel calculated Gross Receipts Tax using the Tennessee Gross Receipts Tax Form. Gas Revenue, AFUDC, and Other Revenues were totaled and Uncollectibles were deducted to arrive at a taxable amount of

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[118] Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule 10, Consumer Advocate Workpaper, Attachment DD 10-1, (August 24, 2018).
[119] CGC's Updated Response to TPUCs Workbook Request, Schedule 5, (August 28, 2018).
[120] Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule 10, Consumer Advocate Workpaper, Attachment DD 10-1, (August 24, 2018).

$71,850,864. The $5,000 exemption was deducted and the statutory 1.50% tax rate was applied resulting in a gross tax of $1,077,688. Forecasted Franchise and Excise Taxes were then deducted, pursuant to the statute. The voting panel unanimously adopted the resulting Gross Receipts Tax of $862,580 for the attrition period ending June 30, 2019.

G(6). ALLOCATED & OTHER TAXES

The Company forecasted $157,412 for allocated & other taxes for the attrition period ending June 30, 2019.[121] The Consumer Advocate forecasted a December 31, 2019 balance of $0 by reclassifying the test period amount of $148,755 to their corresponding accounts: Property Taxes, Payroll Tax, and State Franchise Tax.[122]

The panel found that it is more prudent and reasonable to reclassify the amounts to their corresponding accounts. Reclassification of the amounts to their appropriate accounts will ensure that appropriate growth factors are applied to each individual account, providing more accurate data. Therefore, the panel voted unanimously that $0 in Allocated and Other Taxes be adopted for the attrition period ending June 30, 2019.

H. INCOME TAXES

The Company and the Consumer Advocate each presented its schedules as exhibits for its calculations on the proper amount of income tax. Income Taxes include both the Tennessee Excise Tax and the Federal Income Tax. Income Tax is calculated based on operating margin and expense calculations and applying statutory tax rates. Both CGC and the Consumer Advocate accounted for the impact of the significant changes resulting from the Tax Cut & Jobs

[121] CGC's Updated Response to TPUCs Workbook Request, Schedule 5, (August 28, 2018).
[122] Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule 10, Consumer Advocate Workpaper, Attachment DD 10-1, (August 24, 2018).

Act, which became effective January 1, 2018 in their respective calculations and schedules.[123] Based upon the statutory rates and the other items decided in this rate case, the panel unanimously adopted Net State Excise Tax of $373,213 for the attrition period and Net Federal Income Tax of $264,062, which includes Excess Deferred Tax Liability Amortization of $918,724.

I. NET OPERATING INCOME

Net Operating Income ("NOI") represents the earnings of the Company under present rates that are available after all items of the cost of providing utility service have been considered. The NOI of CGC is the total operating revenue minus total operating expense based upon the determinations of revenues and expenses adopted by the panel.

The summation of operating revenues (i.e., gas sales and transportation, AFUDC and other), results in total operating revenue in the amount of $71,972,727. Thereafter, the operation and maintenance expenses totaling $50,090,166 are subtracted. In addition, depreciation expense, interest on customer deposits, taxes other than income taxes, state excise taxes and federal income taxes are also subtracted. These subtractions result in the removal of a total operating expense in the amount of $62,346,902. Calculation of NOI by subtracting total operating expense from total operating revenue arrives at the net operating income of $9,625,826 which was unanimously adopted by the panel for the attrition period ending June 30, 2019.

J. RATE BASE

Rate Base is the total of the investor funded or supplied plant, facilities, and other investments used by the utility in provisioning service to its customers. The rate base is the investment base to which a fair rate of return is applied to arrive at the net operating income

[123] CGC's Updated Response to TPUCs Workbook Request, Schedule 6, (August 28, 2018); Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule 11, (August 24, 2018).

requirement. The Company recommends a rate base of $157.8 million while the Consumer Advocate maintains that a rate base of $139.1 million should be approved. For the reasons set forth below, the panel unanimously voted to adopt a rate base of $149,739,716 for the attrition year ending June 30, 2019.

Below is a chart summarizing the differences between the rate base components advocated by the Company, those advocated by the Consumer Advocate, and the adopted rate base for the attrition year adopted by the voting panel of the Commission. Following the chart is a discussion of the rate base components.

Additions:	Company	Consumer Advocate	Staff
Utility Plant in Service	$ 301,415,025	$ 301,241,411	$ 301,415,025
Construction Work in Progress	12,457,439	6,580,878	12,457,439
Pension and OPEB Assets	9,009,690	-	-
Working Capital - Lead/Lag	1,519,251	149,625	350,066
Materials & Supplies	403,477	300,612	343,442
Prepayments	46,418	40,653	46,803
Gas Inventory	9,710,633	10,168,496	9,425,959
Deferred Rate Case Expense	1,117,499	260,365	1,117,499
Total Additions	$ 335,679,432	$ 318,742,040	$ 325,156,233
Deductions:			
Accumulated Depreciation	$ 127,903,439	$ 131,951,410	$ 127,903,439
Accumulated Deferred Income Tax	25,514,266	22,678,112	23,114,266
Regulatory Liability-Excess Deferrals	22,177,646	22,074,305	22,177,646
Regulatory Liability - Deferred Tax Savings	-	428,512	-
Customer Advances for Construction	-	-	-
Reserve for Uncollectibles	239,893	180,584	169,708
Reserve for Health Insurance	31,616	33,852	33,409
Other Reserves - Uncliamed Credits	72,013	76,668	72,774
Customer Deposits	1,612,342	1,875,733	1,612,342
Accrued Interest on Customer Deposits	332,933	332,933	332,933
Total Deductions	$ 177,884,147	$ 179,632,109	$ 175,416,517
Rate Base	$ 157,795,285	$ 139,109,931	$ 149,739,716

J(1). Utility Plant in Service, Depreciation and Accumulated Depreciation

Utility Plant in Service ("UPIS") represents the original investment cost to the Company of the assets used in providing utility service. The parties' competing forecasts of UPIS and related accumulated depreciation result in a net rate base difference of $4.2 million. The Company bases its UPIS calculations on a starting balance at June 30, 2017, and then adjusts for actual capital expenditures for 2017 and planned capital expenditures for 2018 and 2019.[124] Plant retirements were estimated based on the average retirements for the four years ended June 30, 2017. With regard to indirect plant, the Company used a 1.90% factor to allocate common plant to Chattanooga Gas, which is based on the percentage of expenses charged to Chattanooga Gas relative to total expenses allocated to all affiliates.[125] To compute related depreciation expense and accumulated depreciation reserve amounts, the Company utilizes the depreciation rates recommended by the depreciation study sponsored its witness, Dane Watson.[126] The depreciation rates were applied to CGC's forecasted UPIS balances to compute attrition year depreciation expense of $8,035,069.[127] The depreciation expense, including estimated and recommended plant retirements, were then applied to the balance as of December 31, 2017, to arrive at the attrition year accumulated depreciation reserve balance.[128]

To project its attrition year UPIS, however, the Consumer Advocate began with the test period ending balance at December 31, 2017, and then increased the plant amounts by the five-year historical average of net plant additions (i.e., the net of additions and retirements over the

[124] Gary Tucker, Pre-filed Direct Testimony, pp. 11-12, (May 11, 2018).
[125] *Id.* at 12.
[126] Dane Watson, Pre-filed Direct Testimony, p. 3, Exhibit DAW-2 (February 15, 2018).
[127] CGC's Updated Response to TPUCs Workbook Request, Schedule 3, (August 28, 2018).
[128] Gary Tucker, Pre-filed Direct Testimony, pp. 15-16, (May 11, 2018).

five-year period).[129] With regard to allocations of common plant, the Consumer Advocate developed an indirect plant allocation factor of 1.63% based on an average of the service company affiliate's throughput volumes and number of customers for 2016 and 2017.[130] The Consumer Advocate accepted and applied the depreciation rates recommended by the Company's depreciation study to its net UPIS balances to compute its attrition year depreciation expense, which then allows for calculation of the Consumer Advocate's accumulated depreciation amount.[131]

In a traditional rate case such as this one, the panel found that known and measurable changes should be applied to normalized test year amounts to determine utility plant and related depreciation and accumulated reserve balances for a forward-looking attrition year. The panel found CGC's methodology for determining plant additions through budgeted capital expenditures to be a reasonable, forward-looking procedure for calculating service rates. Mr. Ziliak testified that CGC's budgeting process considers a number of factors, including: historical spend, known strategic projects, projected impacts of new regulations, labor market and contract bid pricing adjustments, and any other known items affecting the work to be done.[132] He further testified that the Company's budgeting process allows for the greatest accuracy in predicting future spending requirements and is highly reliable.[133] CGC witness Morley testified that its approach is the more appropriate method to calculate the allocation factor for common plant because the service company affiliate's plant is predominantly general plant related to broad functions (e.g., accounting, human resources, supply chain, computer services, etc.).[134] The panel

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[129] William H. Novak, Pre-filed Direct Testimony, p. 17, (July 3, 2018).
[130] *Id.*
[131] *Id.* at 26-27; Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule 11, (August 24, 2018).
[132] Jacob A. Ziliak, Pre-filed Rebuttal Testimony, pp. 4-5, (August 3, 2018).
[133] *Id.* at 5.
[134] Michael J. Morley, Pre-filed Rebuttal Testimony, pp. 22-23, (August 3, 2018).

found Mr. Morley's testimony persuasive and unanimously adopted the Company's allocation factor for common plant.

Mr. Novak notes, in his testimony on behalf of the Consumer Advocate, that the Company's anticipated capital expenditures are greater than historical spends.[135] However, the panel found that the Company's forecast should not be rejected merely because capital expenditures are expected to increase, especially in light of Company testimony supporting the capital projects proposed in this case.[136] Use of historical averages would not recognize planned major projects, such as a two-phase project to connect the Company's existing LNG facility to Red Bank and Signal Mountain by late 2020 at a total cost of $18 million.[137] Moreover, the panel found that the capital budgeting approach used by the Company is consistent with the methodology for determining appropriate levels of UPIS for rate-setting purposes by the Commission in prior rate cases. Therefore, the voting panel unanimously voted to adopt CGC's thirteen-month average of UPIS of $301,415,025 for the attrition year.

As stated above, the parties agreed that the updated depreciation rates recommended by CGC's depreciation study should be applied to plant balances to compute depreciation expense in this case. Because the panel adopted the Company's UPIS balance, based in part on its forward-looking forecast of capital projects and related expenditures, which is also consistent with prior rate case procedures, the panel likewise unanimously adopted CGC's calculation of attrition year annual depreciation expense of $8,035,649. Further, since the accumulated depreciation reserve is a mathematical function of plant balances and associated annual

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[135] William H. Novak, Pre-filed Direct Testimony, pp. 18-19 (July 3, 2018).

[136] Mr. Ziliak gave testimony about the Red Bank and Signal Mountain LNG connection pipeline project, the Lookout Mountain pressure improvement project, the Middle Valley PRIM project, and completion of the bare steel project. Jacob A. Ziliak, Pre-filed Rebuttal Testimony, pp. 6-8, (August 3, 2018); Transcript of Hearing, Vol. II A, p. 93, (August 21, 2018).

[137] Jacob A. Ziliak, Pre-filed Rebuttal Testimony, pp. 6-7, (August 3, 2018); Transcript of Hearing, Vol. II A, p. 93, (August 21, 2018).

depreciation charges, the panel voted unanimously to adopt the Company's thirteen-month average forecast of accumulated depreciation of $127,903,439 for the attrition period ending June 30, 2019.

J(2). CONSTRUCTION WORK IN PROGRESS

Construction Work in Progress ("CWIP") represents the cost of investment that is currently under construction and will be transferred to Plant in Service when completed. The $5.9 million dollar difference in CWIP results from the parties' differing forecasting methodologies. Like the forecast for UPIS, CGC bases its CWIP calculations on a starting balance at June 30, 2017, with adjustments for the level of capital spending and project timing outlined in the Company's capital budget for 2018 and 2019.[138] Contributions in aid of construction ("CIAC") is included as a reduction to plant balance and netted with CWIP.[139] Alternatively, the Consumer Advocate uses a five-year historical average of annual balances to project its attrition year CWIP forecast.[140]

The panel found that because CWIP is determined by plant construction projects and activities, the CWIP forecast should be aligned with the capital expenditure projections used to compute UPIS. Accordingly, and for the same reasons the panel adopted CGC's forward-looking forecast of UPIS, the panel unanimously voted to adopt the Company's thirteen-month average CWIP balance of $12,457,439 for the attrition year in this case.

J(3). PENSION AND OPEB ASSETS

The Company forecasts a rate base addition of $9.0 million related to pension and other post-retirement benefit ("OPEB") assets whereas the Consumer Advocate did not include any

[138] Gary Tucker, Pre-filed Rebuttal Testimony, pp. 9-10, (August 3, 2018).
[139] Gary Tucker, Pre-filed Direct Testimony, p. 17, (May 11, 2018).
[140] William H. Novak, Pre-filed Direct Testimony, p. 18, (July 3, 2018).

provision for pension and OPEB assets in its rate base forecast.[141] In this case, CGC proposes a change to how pension and OPEB expenses and related accruals are treated by this Commission. Mr. Tucker offered testimony recommending the usage of the accounting standards for pensions and OPEBs issued by the Financial Accounting Standards Board ("FASB") to determine the amount of pensions and OPEB costs for ratemaking purposes.[142] The Consumer Advocate, however, states that pension and OPEB expenses should be limited to cash contributions only, which results in no accrued assets in this case.[143] Mr. Novak correctly testified that the Commission has a long-established ratemaking policy of only allowing rate recovery of the minimum required contribution for pension and OPEB expenses.[144] Further, Mr. Novak pointed out that there is no requirement for the Commission to follow the accounting principles established by other authorities, including the "generally accepted accounting principles" promulgated by FASB, as requested by the Company in this case.[145]

The panel concurred with the Consumer Advocate's position on this issue. For decades this Commission has recognized the expense of pension and post-retirement benefits in service rates in accordance with the actuarially-determined minimum contribution requirement, as opposed to the FASB accounting standards proposed by the Company. The panel found that this long-standing ratemaking policy should be maintained going forward. Further, the panel agreed with the Consumer Advocate that determining service rates based on minimum required contributions for pensions and post-retirement benefits is appropriate policy, because it: (1) applies consistently to all utilities, (2) most closely matches today's costs with today's

[141] CGC's Updated Response to TPUCs Workbook Request, Schedule 2, (August 28, 2018); Revised Exhibit of the Consumer Protection and Advocate Division of the Tennessee Attorney General's Office, Schedule 2, (August 24, 2018).
[142] Gary Tucker, Pre-filed Direct Testimony, p. 13, (May 11, 2018).
[143] William H. Novak, Pre-filed Direct Testimony, p. 19, (July 3, 2018).
[144] *Id.* at 20.
[145] *Id.* at 20-21.

customers, (3) is not subject to the same changes in assumptions for market conditions as the actuary's recommended contribution, and (4) is a more stable and consistent amount for setting rates in the near-term.[146] Therefore, the panel voted unanimously to adopt pension and OPEB assets of zero for the attrition year in this case, consistent with established Commission precedent.

J(4). WORKING CAPITAL

Working Capital is the amount of funds necessary for daily expenditures and a variety of non-plant investments that are necessary to sustain ongoing operations of the utility until those expenditures can be recovered through revenues received from customers. CGC projected a cash working capital requirement based on a lead/lag study sponsored by Company witness Adams.[147] Application of the lead/lag study results to CGC's revenues and expenses requiring operating funds results in a net lag of 8.14 days, which, when multiplied by the Company's estimated average daily cost of service, produces a working capital requirement of $1.5 million.[148] The Consumer Advocate applied the Company's lead/lag study, but with three adjustments made to the study's calculation. Mr. Dittemore testified that the Consumer Advocate adjusted the Company's study to: (1) exclude the return on equity from estimated average daily cost of service; (2) reduce the lag days for salaries and wages from 39.02 to 14.01 to reflect the exclusion of the incentive compensation lag; and (3) incorporate the test period average balance of withholdings (i.e., accrued liabilities) for franchise, excise and use taxes.[149] With these adjustments, the Consumer Advocate computes a net lag of 3.46 days, which, when multiplied

[146] *See* William H. Novak, Pre-filed Direct Testimony, p. 21, (July 3, 2018).
[147] Michael J. Adams, Pre-filed Direct Testimony, Exhibit MJA-2 (February 15, 2018).
[148] Gary Tucker, Pre-filed Direct Testimony, pp. 13-17, Exhibits RDJ 2-3, (May 11, 2018).
[149] David Dittemore, Pre-filed Direct Testimony, p. 17, (July 3, 2018).

by the Consumer Advocate's estimated average daily cost of service, produces a working capital requirement of $0.2 million, which is $1.3 million less than the Company's projection.

The Consumer Advocate argues that the exclusion of the return on equity from working capital is appropriate because it is a non-cash expense that does not generate a cash requirement on behalf of the Company, [150] CGC counters that exclusion of the return on equity would fail to account for the timing of the receipt of such return.[151] Further, Mr. Dittemore testified that payment of dividends is optional, and if paid, are paid in arrears with a significant expense lag as opposed to the zero lag days included in the study.[152] Finally, both the Company and the Consumer Advocate point to cases in which both this Commission and other jurisdictions have determined whether the return on equity component should be excluded from the cash working capital computation in favor of their respective positions.[153] The panel found that return on equity is a non-cash expense not generating a cash requirement for the Company, and therefore, exclusion from working capital calculation is appropriate.

Further, based upon the panel's finding concerning disallowance of incentive compensation for rate-setting purposes, the panel finds that the Consumer Advocate's adjustment to reduce the salaries and wages lag to reflect the removal of incentive compensation is appropriate.

Finally, Mr. Dittemore explains that the Consumer Advocate adjusted the cash working capital requirement to reflect the advanced collection of franchise, excise and use taxes by the average balance of these accounts for the test year, because prior to remittance to taxing authorities, these collected funds provide a source of ongoing working capital for the

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[150] *Id.* at 18
[151] Michael J. Adams, Pre-filed Rebuttal Testimony, (August 3, 2018).
[152] David Dittemore, Pre-filed Direct Testimony, p. 18, (July 3, 2018).
[153] *See* David Dittemore, Pre-filed Direct Testimony, pp. 18-19, (July 3, 2018); Michael J. Adams, Pre-filed Rebuttal Testimony, pp. 3-7, (August 3, 2018).

Company.[154] Mr. Adams counters in his rebuttal testimony that he agrees that these taxes should be considered in the working capital calculation, and in fact, were reflected in a reduction for the working capital requirement.[155] The panel found that recognition of these advanced collections is appropriate, and that the test period average balances of these tax liabilities accounts are reasonable approximations of the funds available to the Company for purposes of computing cash working capital.

As the panel found the Consumer Advocate's adjustments to the Company's lead/lag study to be reasonable and appropriate, the panel unanimously adopted the Consumer Advocate's lag days for computing cash working capital in this case. When weighted and applied to attrition year operating expenses, taxes and interest the panel adopted, the panel determined that a net lag of 4.75 days should be applied to a computed average daily cost of service of $180,221, which, when reduced for tax collections withheld of $506,569, results in a calculated cash working capital of $350,066. Therefore, the panel unanimously voted to adopt working capital for the attrition period in the amount of $350,066.

J(5). DEFERRED RATE CASE EXPENSE

The Company is requesting recovery of rate case expenses totaling $1,241,665, to be amortized over five years.[156] As discussed above, this results in an attrition year rate case expense of $248,333 and a thirteen-month average deferred rate case expense addition to rate base of $1,117,499[157] for the attrition year. In contrast, as discussed briefly in section C(8) herein, the Consumer Advocate estimates a much lower amount of rate case expense of

[154] David Dittemore, Pre-filed Direct Testimony, pp. 19-20 (July 3, 2018).
[155] Michael J. Adams, Pre-filed Rebuttal Testimony, pp. 9-10, (August 3, 2018).
[156] *Post-Hearing Brief of Chattanooga Gas Company*, p. 14, (September 10, 2018); CGC's Updated Response to TPUCs Workbook Request, Schedule 4, (August 28, 2018).
[157] *Post-Hearing Brief of Chattanooga Gas Company*, p. 39, (September 10, 2018); CGC's Updated Response to TPUCs Workbook Request, Schedule 2, (August 28, 2018).

$347,152, with a three-year amortization period to arrive at an attrition year amortization expense of $115,718 and a thirteen-month attrition year average of deferred rate case expense of $260,365.[158]

The Consumer Advocate eliminates certain expenses from CGC's proposed rate case expense, classifying the eliminated expenses as unreasonable.[159] Mr. Novak testified that he excluded consultant's costs related to the class cost of service study ("CCOSS") from recovery because CCOSS studies have never been approved by the Commission.[160] Mr. Novak also gave testimony that he eliminated other consultants' costs because CGC had not supported by records or testimony that costs were a necessity.[161] The Consumer Advocate eliminated 50% of estimated legal expenses asserting that the hiring of two separate law firms for this case is duplicative and imprudent and also contending that a portion of legal expenses should be paid by stockholders since the stockholders also receive benefits from the rate case.[162] Mr. Novak testified that he included only $200,000 as appropriate legal costs for this case in rate case expense.[163]

The Company, however, disagreed with the Consumer Advocate's adjustments to rate case expense. The Company asserted that consultants are needed to organize and manage the case, and that legal expertise is necessary in order to assure the case stays on course.[164] Rate case costs also include items not routinely undertaken, such as lead-lag and depreciation studies, which if not recovered for outside consultants, would force the Company to hire employees to

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[158] William H. Novak, Pre-Filed Direct Testimony, pp. 23, 25 (July 3, 2018).
[159] *Consumer Advocate's Post-Hearing Brief*, p. 27 (September 10, 2018); William H. Novak, Pre-filed Direct Testimony, pp. 23-25, (July 3, 2018).
[160] William H. Novak, Pre-filed Direct Testimony, p. 24, (July 3, 2018).
[161] *Id.*; *See also Consumer Advocate's Post-Hearing Brief*, p. 27 (September 10, 2018).
[162] William H. Novak, Pre-filed Direct Testimony, pp. 24-25, (July 3, 2018); *Consumer Advocate's Post-Hearing Brief*, p. 27 (September 10, 2018).
[163] William H. Novak, Pre-filed Direct Testimony, p. 25, (July 3, 2018).
[164] Gary Tucker, Pre-filed Rebuttal Testimony, pp. 21-24 (August 3, 2018).

perform these functions internally at costs that could potentially exceed the outside costs incurred.[165] Further, the Company argued that the $200,000 the Consumer Advocate allowed for legal costs was arbitrary, as it was not supported by any reference or documentation on how the amount was calculated.[166] CGC also argued that some of the high case expenses of this rate case are related to unanticipated delays in filing the case relating to the passage of the Tax and Jobs Act in December of 2017 requiring the Company to redo it case, the extremely high number of discovery requests from the Consumer Advocate, and the need to put together a rebuttal case that required more rebuttal witnesses than direct witnesses.[167]

As previously indicated, the panel noted its concern with regard to the high amount of rate case expenses. It is evident that both ratepayers and stockholders receive a benefit from the rate increases that generally result from the completion of rate cases. The ratepayers receive the benefit of the facility repairs and upgrades ensuring a safe and reliable system and the resources necessary to cover reasonable operating expenses to ensure efficient operations from the Company's increase revenue. At the same time, the stockholders receive the benefit of higher equity returns which leads to increased stock prices as a result of the increased revenues. CGC acknowledges the benefit of rate cases to both ratepayers and stockholders in the testimony of Mr. Dallas.[168]

The Company bears the burden of proving its just and reasonable expenses pursuant to Tenn. Code Ann. § 65-5-103(a). The panel found that CGC provided sufficient testimony and documentation to justify its rate case expenses as reasonable. Further, while the panel noted its concern about the high rate case expense and noted the benefit of rate increases to both

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[165] *Id.* at 23-24.
[166] *Id.* at 23.
[167] *Post-Hearing Brief of Chattanooga Gas Company*, pp. 14-15, (September 10, 2018).
[168] Transcript of Hearing, Vol. I A, pp. 79-80, (August 20, 2018).

ratepayers and stockholders, it found that there is insufficient evidence in the record to determine the relative benefits of this proceeding to ratepayers and stockholders by which to apportion the rate case among the ratepayers and shareholders. Absent such evidence, the panel determined that any exclusion from rate case expense based upon this distinction is unsupported and potentially arbitrary. Therefore, the panel unanimously voted to approve the rate case expense of $1,241,665 be recovered over a five-year period as proposed by the Company, resulting in a thirteen-month average of deferred rate case expense of $1,117,499 for the attrition period.

J(6). OTHER RATE BASE ADDITIONS

The remaining items, materials & supplies, prepayments and gas inventory are addressed collectively, the same calculation methodology applying to each of these accounts which represent an investment on which the Company should be allowed to earn a reasonable return. CGC utilized the thirteen-month average for the test period ended December 31, 2017 to project materials & supplies and prepayments for the attrition year. The Company forecasted $9,710,633 for gas inventory for the attrition year.[169] The Company started with the actual balances in stored gas inventory at December 31, 2017, and made projections based on the Company's planned business operations through the attrition year.[170] The Company used forecasted monthly volumes of stored gas inventory and projected NYMEX prices through the attrition year to estimate the dollar amount of its injections and withdrawals, also including the cost of liquefaction in the calculation for the LNG storage facility.[171] Alternatively, the Consumer Advocate forecasted attrition year materials & supplies, prepayments and gas inventories based on five-year historical

[169] Gary Tucker, Pre-filed Direct Testimony, p. 14 and Exhibit RDJ-2, (May 11, 2018); *See also Post-Hearing Brief of Chattanooga Gas Company*, pp. 38-39, (September 10, 2018).
[170] Gary Tucker, Pre-filed Rebuttal Testimony, p. 20 (August 3, 2018).
[171] Gary Tucker, Pre-filed Direct Testimony, p. 14 (May 11, 2018).

averages of each account, which the Consume Advocate claims represents a normalized level of activity for the attrition year. [172]

The panel found that utilizing the test year average is too limited because of the upward and downward variations of the monthly and annual balances of these accounts caused by the activities and operational needs of the Company. In addition, the panel found that while a multi-year average should be examined to capture a trend of normalized activity for ratemaking purposes, a three-year average, as opposed to the five-year average proposed by the Consumer Advocate, provides a more accurate reflection of the recent operational trends in these accounts. Therefore, the panel utilized a three-year, thirteen-month historical average to estimate materials & supplies, prepayments and gas inventories for the attrition year. Using this method, the panel arrived at an estimated thirteen-month average attrition year balance of $343,442 for materials & supplies, $46,803 for prepayments, and $9,425,959 for gas inventory and voted unanimously to adopt these amounts.

J(7). Accumulated Deferred Income Tax and Regulatory Liability for Excess Deferrals

Accumulated Deferred Income Tax represents the accumulated differences between accounting or book income and taxable income. While some of these differences are permanent, others involve temporary or timing matters that reverse in subsequent years. CGC computed accumulated deferred income tax ("ADIT") by using the booked amounts as of December 31, 2017, and then forecasting through June 2019.[173] Existing property, plant and equipment balances with known changes were used to estimate the tax and book depreciation, with the difference multiplied by the income tax rates to arrive at ADIT. The effect of the newly enacted Tax Cuts and Jobs Act was also included in the determination of ADIT, with tax depreciation

[172] William H. Novak, Pre-filed Direct Testimony, pp. 21-22 (July 3, 2018).
[173] Gary Tucker, Pre-filed Direct Testimony, p. 16, (May 11, 2018).

using the Modified Accelerated Cost Recovery System ("MACRS") for 2018 and 2019, without bonus depreciation, except for approximately $3.6 million of assets acquired during the fourth quarter of 2017 that are expected to be placed into service during the first quarter of 2018. The balance of excess deferred income tax ("EDIT") was also calculated and included with the ADIT forecast as a regulatory liability.[174] Mr. Tucker testified that the ADIT amount related to its computed pension asset is $1.7 million, and ADIT related to the OPEB asset is $0.7 million, and that these amounts should be deducted from ADIT if its pension and OPEB assets are excluded from rate base.[175]

With regard to amortization of EDIT, Mr. Tucker testified on behalf of CGC that amortization of the protected EDIT related to depreciable property must be amortized over the life of the related property in accordance with the average rate assumption method, which is one of the amortization methods approved by the IRS. Further, Mr. Tucker stated that compliance with the tax code required the amortization of the protected EDIT to begin with the income tax rate reduction effective January 2018 without delay.[176] The Company proposes to amortize its calculated unprotected EDIT over five years, aligning with its recommended amortization of rate case costs.[177]

The Consumer Advocate agreed with CGC's calculation of ADIT, as well as the protected and unprotected computations of EDIT.[178] However, Mr. Dittemore testified on behalf of the Consumer Advocate that he disagreed with the five-year amortization periods proposed by the Company. Mr. Dittemore recommends that EDIT amortization not commence until the effective date of the rate change ordered in this docket, but he does not object to the Company's

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[174] *Id.* at 16-17.
[175] Gary Tucker, Pre-filed Rebuttal Testimony, pp. 18, 20, (August 3, 2018).
[176] *Id.* at 38-39.
[177] *Id.* at 38.
[178] David Dittemore Pre-Filed Direct Testimony, pp. 24-27 (July 3, 2018).

amortization of protected EDIT over the life of the related depreciable property.[179] Mr. Dittemore, however, recommends that the unprotected EDIT be amortized over three years rather than the five-year period proposed by the Company because "these amounts belong to the ratepayers..."[180]

The most significant portion of ADIT relates to differences in the methods used for computing depreciation expense for tax purposes versus ratemaking purposes. As the voting panel adopted CGC's Utility Plant In Service and associated depreciation expense amounts and the Consumer Advocate does not object to CGC's computation of ADIT, the panel found that the Company's ADIT calculation of $25,514,266[181] be reduced by $2.4 million[182] to reflect the ADIT associated with removal of the Company's proposed pension and OPEB assets from rate base. Using this calculation, the voting panel arrived at an ADIT of $23,114,266 for the attrition year, which it voted unanimously to adopt. Further, the panel voted unanimously to adopt the Company's amortization periods for both protected and unprotected, and to adopt an EDIT regulatory liability of $22,177,646 for the attrition year. In addition, the voting panel ordered CGC to accrue into a regulatory liability account all amortized amounts of EDIT for the period from January 2018 to the effective date of the rate change ordered in this docket, with the disposition of the regulatory liability to be determined in Docket No. 18-00035.

J(8). RESERVES FOR UNCOLLECTIBLES, HEALTH INSURANCE AND UNCLAIMED CREDIT

Reserves for uncollectibles, health insurance and other/unclaimed credits represent non-investor supplied funds available to the Company and should therefore be deducted from rate base. The Company forecasted the reserve for uncollectibles by calculating the average historical

[179] *Id.* at 25-26.
[180] *Id.* at 26.
[181] CGC's Updated Response to TPUCs Workbook Request, Schedule 2, (August 28, 2018).
[182] Gary Tucker, Pre-filed Rebuttal Testimony, pp. 18, 20, (August 3, 2018).

reserve from January 2016 through December 2017 and then applying that ratio to the estimated operating margin for the attrition period; and it used the thirteen-month average balance of the test year ending December 31, 2017 to forecast the reserves for unclaimed credits and health insurance.[183] The Consumer Advocate forecasted all of these reserve balance accounts for the attrition year by computing a five-year historical average of the annual balances in these accounts.[184]

As it found with regard to materials & supplies, prepayments and gas inventory, the panel found that utilizing a test year average does not allow for the upward and downward variations of the monthly and annual balances of these accounts caused by the activities and operational needs of the Company. Further, the volatility in the uncollectible reserve account suggests that this reserve has not been in correlation with associated annual revenues. In addition, the panel found that while a multi-year average should be examined to capture a trend of normalized activity for ratemaking purposes, a three-year average, as opposed to the five-year average proposed by the Consumer Advocate, provides a more accurate reflection of the recent operational trends in these accounts. Therefore, the panel utilized a three-year, thirteen-month historical average to estimate the reserves for uncollectibles, health insurance and unclaimed credits for the attrition year. Using this method, the voting panel unanimously voted to adopt the amounts calculated for these reserve balance accounts: an estimated thirteen-month average attrition year balance of $169,708 for the reserve for uncollectibles; $33,409 for the reserve for health insurance; and $72,774 for the reserve for unclaimed credits.

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[183] Gary Tucker, Pre-filed Direct Testimony, p. 15, (May 11, 2018); *See also* Gary Tucker, Pre-filed Rebuttal Testimony, pp. 20-21 (August 3, 2018); CGC's Updated Response to TPUCs Workbook Request, Schedule 2, (August 28, 2018)..

[184] William H. Novak, Pre-filed Direct Testimony, pp. 29-30 (July 3, 2018).

J(9). CUSTOMER DEPOSITS AND ACCRUED INTEREST ON CUSTOMER DEPOSITS

Customer deposits are amounts advanced by customers to the Company and therefore represent a source of non-investor supplied funds which the Company has available to finance a portion of its utility investment. Likewise, accrued interest on customer deposits held by the Company represent non-investor supplied funds. Thus, customer deposits and associated accrued interest should be deducted from the rate base on which investor returns are computed.

The Company forecasted customer deposits for the attrition year by applying the most recent three-year average growth rate to the deposits held on December 31, 2017.[185] The Company states that this approach captures a new system that was implemented in December 2017 called Customer Care and Billing ("CC&B") which allows for more frequent review of customer deposit accounts and more timely refunds of the customer deposits.[186] Mr. Tucker testified that the CC&B system results in continued lower balances of the customer deposits account in the future. As a result of the recent system change, CGC utilized the interest accrued for the test year ended December 31, 2017 to estimate attrition year accrued interest.[187] Consistent with its other rate base calculations, the Consumer Advocate used a five-year historical average of the annual balances to forecast customer deposits for the attrition year, but it agreed with the Company's forecast for accrued interest on customer deposits.[188]

The panel found that the implementation of the CC&B program in December 2017 should result in better management and more-timely refunding of customer deposits going forward. Based upon the Company's detailed information on the CC&B program and its implementation, the voting panel found that CGC's methodology for forecasting customer

[185] Gary Tucker, Pre-filed Direct Testimony, p. 15 (May 11, 2018).
[186] Gary Tucker, Pre-filed Rebuttal Testimony, p. 25, (August, 3, 2018).
[187] *Id.*
[188] William H. Novak, Pre-filed Direct Testimony, pp. 29-30 (July 3, 2018).

deposits and related accrued interest is reasonable. Therefore, the panel unanimously voted to adopt $1,612,342 for customer deposits and $332,933 for accrued interest on customer deposits for the attrition year.

K. REVENUE CONVERSION FACTOR

The Revenue Conversion Factor represents the adjustment factor necessary to translate any surplus or deficiency in NOI into a Revenue Deficiency or Surplus that rates will be designed to produce. To produce a certain amount of revenue several factors are considered. In order to determine the proper amount of revenue needed for the Company to have the opportunity to earn a fair rate of return, it is necessary to apply a revenue conversion factor to Net Income Deficiency or the NOI. After this amount is calculated, it is necessary to add forfeited discounts and subtract uncollectibles, state excise tax, and federal income tax. Based upon a Forfeited Discounts Factor of 0.008796, an Uncollectible Ratio of 0.003825, State Excise Tax rate of 6.5%, and a Federal Income Tax rate of 21%, the panel arrived at and unanimously voted to adopt an overall Revenue Conversion Factor of 1.347169.

L. RATE OF RETURN

The goal of regulatory rate setting is to ensure a fair rate of return on a company's investments while ensuring the safety and reliability of the service provided. Fair rate of return standards developed from the United States Supreme Court decisions in *Bluefiled Water Works & Improvement Company* v. *P.S.C. of West Virginia*[189] and *Federal Power Commission v. Hope Natural Gas Company.*[190] A fair rate of return is achieved when (1) the return is comparable to other businesses that bear similar risks; (2) the allowed return is sufficient to ensure financial

[189] *Bluefield Water Works & Improvement Co. v. P.S.C. of West Virginia*, 262 U.S. 679 (1923).
[190] *F.P.C. v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

integrity; and (3) the company can attract, at reasonable cost, credit to meet its capital requirements.

The process of determining the cost of capital involves three steps. First, the capital structure of the firm must be established. In this proceeding, the Commission must determine whether to adopt a double leverage capital structure methodology, as proposed by the Consumer Advocate. Second, the cost of each component of the capital structure – debt and equity – must be calculated. Finally, the overall return is computed by calculating the weighted cost of capital.

The current authorized 7.41% rate of return for CGC was established in Docket No. 09-00183. The currently authorized return on equity established in Docket No. 09-00183 is 10.3%.[191] In the instant proceeding, CGC proposes an 11.25% equity return[192] and an overall rate of return of 7.83%.[193] The Consumer Advocate proposes an equity return of 9.0% and an overall rate of return of 5.93%.[194]

L(1). CAPITAL STRUCTURE

The Company's proposed capital structure is based upon the consolidated capital structure of its parent, Southern Company Gas, and is composed of 44.47% long-term debt, 6.3% short-term debt and 49.23% equity.[195]

The Consumer Advocate's capital structure is based upon the "double leverage" approach to account for the parent-subsidiary relationship between CGC, its parent Southern Company Gas (SCG), and SCG's parent holding company The Southern Company (TSC).[196] Essentially,

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[191] *In Re: Petition of Chattanooga Gas Company for a General Rate Increase, Implementation of the Energysmart Conservation Programs and Implementation of a Revenue Decoupling Mechanism*, Docket No. 09-00183, *Order*, p. 66, (November 8, 2010).
[192] James H. Vander Weide, Ph.D., Pre-filed Direct Testimony, p. 52, (February 15, 2018).
[193] Gary Tucker, Pre-filed Direct Testimony, p. 5-6, (May 11, 2018).
[194] Christopher C. Klein, Ph.D., Pre-filed Direct Testimony, p. 22, (July 3, 2018).
[195] Gary Tucker, Pre-filed Direct Testimony, p. 18 (May 11, 2018).
[196] Dr. Klein defined double leverage in his testimony as follows: "Double leverage 'usually refers to a situation where a holding company raises debt and downstreams it as equity capital, or subordinated debt, to a subsidiary, i.e.,

the double leverage calculation proposed by Dr. Klein applies the weighted cost of capital of TSC to the equity portion of SCG's capital structure. When computing his double leverage capital structure, Dr. Klein accepts the capital structure for SGC proposed by the Company, noting "... I find Mr. Tucker's recommended capital structure of SCG and its cost rates to be reasonable, except for ignoring the parent-subsidiary relationship between SCG and TSC."[197] The Consumer Advocate's proposed double leverage capital structure, broadly measured, is composed of 35% equity and 65% debt.[198] Dr. Klein Further testified that when using his proposed 9% equity return, the double leverage methodology reduces overall cost of capital by approximately 70 basis points.[199]

The Consumer Advocate correctly observes that this Commission and its predecessors have recognized the importance of the parent-subsidiary relationship when determining capital structure. In addition, the Consumer Advocate is also correct to note that this agency has used the double-leverage methodology in prior cases. However, the prior decisions of the agency do not mandate the use and application of double-leverage in this proceeding. Previous CGC rate cases, TPUC Docket No. 09-00183 and TPUC Docket No. 04-00034 utilized the capital structure of AGLR, the parent company of CGC, when determining CGC's capital structure.[200] The agency

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it is the use of debt by both the parent company and the subsidiary, in combination with the company's equity capital, to finance the assets of the subsidiary.' [citation omitted] In the regulatory context, 'double leverage...as commonly propounded instructs that the weighted average cost of capital of the parent company of a subsidiary be used as a measure of the cost of equity of a subsidiary.' [citation omitted]." Dr. Klein further states that the purpose of the double-leverage approach is to recognize the parent-subsidiary relationship by sharing some of the benefits of that relationship with ratepayers. Christopher C. Klein, Ph.D., Pre-filed Direct Testimony, p. 9, (July 3, 2018).

[197] *Id.* at 8.

[198] The specific values for the components of the Consumer Advocate's capital structure are found in the Confidential Exhibits attached to Dr. Klein's Testimony. Christopher C. Klein, Ph.D., Pre-filed Direct Testimony, Confidential Exhibits, p. 11, (July 3, 2018).

[199] Christopher C. Klein, Ph.D.. Pre-filed Direct Testimony, p. 11, (July 3, 2018).

[200] *In Re: Petition of Chattanooga Gas Company for a General Rate Increase, Implementation of the Energysmart Conservation Programs and Implementation of a Revenue Decoupling Mechanism*, TPUC Docket No. 09-00183, *Order,* pp. 41-43, (November 8, 2010); *In Re: Petition of Chattanooga Gas Company for Approval of Adjustment of its Rates and Chares and Revised Tariff*, TPUC Docket No. 04-00034, *Order*, pp. 41-44, (October 20, 2004). *See also* Gregory Macleod, Pre-filed Rebuttal Testimony, p. 2 (August 3, 2018).

specifically declined to use double-leverage methodology in Docket No. 04-00034[201] and is unable to cite the use of double-leverage by the agency to calculate the capital structure or rate of return in a deliberated gas case since 2005.

The panel found that the use of double-leverage in this proceeding would result in a rate of return that is not comparable to similar companies and therefore rejected the application of double-leverage in this case. The use of the double-leverage approach generally leads to capital structures with smaller equity ratios. As equity is the most expensive form of capital, smaller equity ratios result in a lower weighted cost of capital. The Consumer Advocate presented an exhibit during the Hearing, Trial Exhibit 5, which shows that the average rate of return in the first quarter of 2018 for gas utilities was 7.14% and 6.89% for electric utilities during the same period.[202] Further, Company witness Dr. Vander Weide provides a study that shows the average overall return for natural gas utilities in 2017 through year-to-date 2018 is 7.33%.[203] The Consumer Advocate's witness recommends a rate of return that is over 120 basis points beneath the average return for gas utilities and almost 100 basis points beneath the average rate of return set for electric utilities.[204] Given the large difference between Consumer Advocate witness Dr. Klein recommended double-leverage based rate of return of 5.93% and the average recent rates of return decisions for other companies, the panel found that adopting the Consumer Advocate's methodology would run counter to the comparability requirement of the *Hope* and *Bluefield* decisions. As such, the panel rejected the double leverage capital structure and rate of return proposed by the Consumer Advocate.

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[201] *In Re: Petition of Chattanooga Gas Company for Approval of Adjustment of its Rates and Chares and Revised Tariff*, TPUC Docket No. 04-00034, *Order*, p. 44, (October 20, 2004).
[202] S&P Global Market Intelligence, RRA Regulatory Focus Major Rate Case Decisions – January – March 2018, www.spglobal.com/marketintelligence, p. 7, (April 17, 2018). Transcript of Hearing, Vol. I B, Trial Exhibit 5, p. 120, (August 20, 2018).
[203] James Vander Weide, Ph.D., Pre-filed Rebuttal Testimony, p. 23, (August 3, 2018).
[204] Christopher C. Klein, Ph.D.. Pre-filed Direct Testimony, p. 22, (July 3, 2018).

This rate case presents a matter of first impression for the Commission, being the first proceeding in which a natural gas company is ultimately a subsidiary of a holding company that owns both other natural gas companies and electric companies. As a result of this novel issue, the panel was required to determine whether the cost of capital for CGC should stand on the basis of its role as a natural gas distribution company or on the basis of its ultimate owner, The Southern Company, an energy conglomerate with both electric and gas companies. As discussed above, the Consumer Advocate's approach to place emphasis on CGC's' ties to the electric industry using its double-leverage method results in a rate of return that is not comparable to recent decisions for either natural gas or electric utilities. Therefore, the panel found that the Company should be valued relative to other natural gas utilities. In part, the decision to determine the cost of capital in this case relies on its financial relationship to its immediate parent Southern Company Gas and its need to secure capital in competition with its other gas distribution subsidiaries of Southern Company Gas.

The panel found that adoption of the capital structure of Southern Company Gas proposed by Company is reasonable and appropriate. The capital structure proposed by CGC witness Gary Tucker is composed of 44.47% long-term debt, 6.3% short-term debt and 49.23% equity and is comparable in composition to capital structures adopted by the agency. The Consumer Advocate witness, Dr. Klein accepted this capital structure for use in his double leverage calculation. Further, the panel found that using the capital structure for Southern Company Gas is analogous to its treatment in prior agency proceedings as CGC's capital structure is set by using a parent company's capital structure that is engaged in the natural gas business. Therefore, the panel adopted the capital structure proposed by the Company containing 44.47 long-term debt, 6.3% short-term debt and 49.23% equity.

L(2). COST OF DEBT

The panel adopted the short-term and long-term debt costs proposed by The Company, which were also accepted by the Consumer Advocate as part of its capital recommendation. Therefore the panel found that the costs of short-term debt and long-term debt for SCG are 3.01% and 4.73%, respectively.

L(3). RETURN ON EQUITY

The final piece of information needed to determine the weighted cost of capital is the appropriate equity return. There is no simple single-step process for setting the appropriate equity return. There are a number of factors used to determine the equity return, including: the results of the parties' models, prevailing economic conditions, rulings of other state commissions, and other factors that may provide evidence about the risk of investing in CGC or SCG. The Company requested an 11.25% equity return.[205] The Consumer Advocate proposes a 9.0% equity return.[206] The currently authorized return on equity established in Docket No. 09-00183 is 10.3%.[207]

Determination of the return on equity utilizes "estimation" techniques that rely on comparable companies. This estimation process provides useful information about the equity cost for a company in the same industry where inputs to models used to determine the cost of equity are difficult to measure. While CGC and SCG present especially acute problems with regard to the difficulty in measuring inputs due to the non-public trade of their stock, the uncertainty in the estimate of the cost of equity for any individual company can be greatly reduced by applying cost of equity methods to a sample of comparable companies.

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[205] James H. Vander Weide, Ph.D., Pre-filed Direct Testimony, p. 52, (February 15, 2018).
[206] Christopher C. Klein, Ph.D.. Pre-filed Direct Testimony, p. 6, (July 3, 2018).
[207] *In Re: Petition of Chattanooga Gas Company for a General Rate Increase, Implementation of the Energysmart Conservation Programs and Implementation of a Revenue Decoupling Mechanism*, TPUC Docket No. 09-00183, *Order,* p. 45, (November 8, 2010).

In the present case, the determination of comparable companies is an important distinction. As discussed above, the panel found that the cost of equity capital employed by CGC should be valued relative to other gas companies. The comparable companies used by the Company are a set of natural gas companies.[208] The Consumer Advocate relies on comparable companies that blend ownership of electric and gas utilities.[209] Based upon its finding, the panel placed greater emphasis on the results of valuation models using the natural gas company comparable companies provided by the Company. The panel found, based upon the testimony of Dr. Klein, that the equity return using gas-electric utility companies is less than comparable returns from a sample of gas companies. Using the zone of reasonableness concept, the panel found the Consumer Advocate's 9% equity return recommendation as a useful lower bound on the return on equity in this proceeding.

While the panel agreed with the use of the Company's choice of comparable companies, it rejected the Company's recommended 11.25% equity return, finding that the Company's recommendation is out of line with the average equity returns for natural gas utilities in 2017 and the first quarter of 2018 and exceeds the highest awarded equity return for the same time period.[210] The panel determined that CGC's recommended ROE is clearly inconsistent with decisions related to companies in the natural gas business from other states. Such incomparability violates the canon principles of the *Hope* and *Bluefield* decisions, which prohibit returns that are incomparably low and incomparably high.

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[208] James H. Vander Weide, Ph.D., Pre-filed Direct Testimony, p. 6, (February 15, 2018).
[209] Christopher C. Klein, Ph.D.. Pre-filed Direct Testimony, p. 12, (July 3, 2018).
[210] The average awarded equity return in rate cases for natural gas utilities, in 24 cases, was 9.72%. The average equity return awarded in rate cases for natural gas utilities during the first quarter of 2018 was 9.68%. The highest awarded equity return for a natural gas utility during the first quarter of 2018 was 10.19% awarded to a Florida utility in March, 2018. S&P Global Market Intelligence, RRA Regulatory Focus Major Rate Case Decisions – January – March 2018, www.spglobal.com/marketintelligence, pp. 9-10, (April 17, 2018). Transcript of Hearing, Vol. I B, Trial Exhibit 5, p. 120, (August 20, 2018).

In addition, CGC based its recommended ROE upon an adjustment accounting for the difference in the after tax market weighted capital structure of the Company relative to its comparable companies.[211] Dr. Klein testified on behalf of the Consumer Advocate:

> There are several practical issues in a regulatory context. First, this approach to the cost of equity has never been adopted in Tennessee before. The companies regulated by the TPUC and its predecessors remain financially viable despite this. Hence, there seems to be no necessity for taking into account a common WACC and calculating an adjusted cost of equity as Dr. Vander Weide proposes. Secondly, his calculation of the WACC for his comparable firms requires some estimation of the capital structure and debt costs of these firms. To the extent these approximations are not accurate, his estimates of the WACC for his comparable firms may be inaccurate or biased. Consequently, his adjusted cost of equity for CGC is also inaccurate.[212]

Following the guidance of *Hope* and *Bluefield* with regard to comparable decisions on returns and the analysis concerning the adjustment taken by the Company, the panel found a sufficient basis to reject the Company's 11.25% proposed equity return.

The Company's 11.25% percent equity return recommendation is based upon an adjustment to the determination that the return on equity should be set at 10.3%, based upon the implementation of an ensemble of valuation models.[213] This 10.3% return is based on models implemented utilizing methods that are inconsistent with prior decisions of the agency. First, Dr. Vander Weide used the ex ante and ex post risk premium models which this agency has not adopted on the basis of the results not being specific to the company or the set of comparable companies.[214] Next, Dr. Vander Weide used quarterly DCF models, which the agency has not adopted, finding that the annual model is a more accurate model, as it does not inflate the return

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[211] James H. Vander Weide, Ph.D., Pre-filed Direct Testimony, pp. 4-5, (February 15, 2018).
[212] Christopher C. Klein, Ph.D., Pre-filed Direct Testimony, pp. 21-22, (July 3, 2018).
[213] James H. Vander Weide, Ph.D., Pre-filed Direct Testimony, p. 4, (February 15, 2018).
[214] *In Re: Petition of Tennessee American Water Company For A General Rate Increase*, TPUC Docket 10-00189, *Final Order*, p. 128 (April 27, 2012).

on equity, unlike the quarterly model.[215] Finally, the agency has rejected the addition of floatation costs when there is no accompanying issuance of stock.[216] The Company indicated that there are no planned stock issuances for Chattanooga Gas or Southern Company Gas for the next five fiscal years.[217] The panel found that given these observations, it is reasonable to recast Dr. Vander Weide's analysis to reflect the previous decisions of the agency, the end result being an upper bound equity return of 9.9%.[218]

The panel chose to implement the Capital Asset Pricing Model ("CAPM") using information provided by the parties to assist in the determination of the equity return. The fundamental idea underlying the CAPM is that investors demand higher returns for assuming additional risk. The CAPM produces a quantitative measure of the additional return required for bearing additional risk. The additional return needed to induce an investor to engage in a riskier investment is known as the risk premium.

To understand the results of the CAPM based upon economic conditions expected during the attrition period, the panel performed its own analysis. The formal representation of the CAPM is:

$$K = R_f + \beta(R_m - R_f)$$

Where:
K = expected return
R_f = risk-free return
R_m = overall market return
β = measure of asset risk relative to market risk.

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[215] *Id.*
[216] *Id.*
[217] Gary Tucker, Pre-filed Direct Testimony, p. 3, (May 11, 2018). *See also* MFG-95, (February 15, 2018).
[218] The 9.9% figure is derived by eliminating the ex ante and ex post risk premium models from the results summarized in Table 2 in Dr. Vander Weide's Direct testimony and subtracting 15 basis points from the remaining model results to reflect the elimination of floatation costs. The results of the discounted cash flow model were not recalculated to reflect annual payments, thus the panel determined the 9.9% estimate to be an upper bound of the equity return for capital used by CGC.

For overall market risk, the Parties both used a 6.9% long-run risk premium.[219] For the other inputs, the panel considered the values used by each party and made a determination about its utilization in the CAPM calculation.

The panel first utilized a risk-free return of 3.04% for use in the CAPM calculation, based upon the then-current yield on the 20 year Treasury bond used by Dr. Klein in his CAPM implementation.[220] However, upon completion of calculations, the panel arrived at equity return values lower than and not comparable to the CAPM result listed in the recent decisions reflected in Trial Exhibit 5. As a result, the panel noted that it shares the concern expressed by Company witness Dr. Vander Weide, that the low interest rate environment that has been evident since CGC's last rate proceeding has produced CAPM equity returns that biased low.[221] Similarly, due to anticipated action by the Federal Reserve with regard to interest rates, the panel noted that that using current interest rates as a measure for the risk-free rate will be unrepresentative of rates in the near term. Therefore, the panel implemented calculations of the CAPM with the 4.2% risk free rate used by Dr. Vander Weide.[222] However, to buffer against uncertainty in the interest rate forecast used by Dr. Vander Weide, the panel also implemented the CAPM using the average of the 4.2% forecast and the 3.04% then-current 20 year Treasury rate used by Dr. Klein.

Finally, the panel initially used a BETA value of 0.74 derived as the average of ValueLine BETAs for the comparable gas companies identified by the Company.[223] However, as with the initially used risk-free return value, this BETA value resulted in incomparably low CAPM results. Both witnesses accept that when companies have BETA statistics that are less than one, that CAPM equity return may be understated. To correct for this, Dr. Vander Weide

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[219] *Id.*; James H. Vander Weide, Ph.D., Pre-filed Direct Testimony, p. 40, (February 15, 2018).
[220] Christopher Klein, Ph.D., Pre-filed Direct Testimony, Exhibit p. 4, (July 3, 2018).
[221] James H. Vander Weide, Ph.D., Pre-filed Rebuttal Testimony, pp. 10-11, (August 3, 2018).
[222] *Id.* at 39.
[223] James H. Vander Weide, Pre-filed Direct Testimony, p. 39 & Exhibit JVW-1, Schedule 6, (February 15, 2018).

sets BETA = .9, while Dr. Klein implements his CAPM on his electric company comparable using BETA = 1.[224] While this agency has not adjusted for BETA statistics less than 1 in previous cases,[225] in the present case, such adjustment is useful as it assists in the counteraction of the abnormally low current interest rate environment, and both parties agree the practice is acceptable.[226]

Implementing the CAPM with BETA = .9, risk premium = 6.9%, and risk free return of 3.62% yields an equity return of 9.8%. The panel found that the calculation is a reasonable implementation of the CAPM. Further, the panel found the equity return to be similar to the average first quarter gas rate case ROE of 9.68% found in Trial Exhibit 5. In addition, the panel found the equity return to be comparable to the 9.8% which was awarded to NICOR, an affiliate of CGC, in its rate case in Illinois.[227] Finally, the recast results of Dr. Vander Weide's analysis supported a 9.9% equity return. Therefore, the panel found that a 9.8% equity return is supported by the record and leads to a comparable return for the equity capital deployed by CGC and unanimously voted to adopt 9.8% as the appropriate equity return for use in this proceeding.

L(4). OVERALL RATE OF RETURN

Based upon the above findings for relevant debt and equity costs, the panel calculated an overall cost of capital of 7.12% for CGC. The average rate of return for gas utilities awarded in the first quarter of 2018 is 7.14%, as shown in Trial Exhibit 5. The voted unanimously to adopt overall cost of capital of 7.12%, finding, based upon comparison with the Parties proposals and recent decisions in other states that it is within the zone of reasonableness.

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[224] *Id.* at 42-48; Christopher C. Klein, Ph.D., Pre-filed Direct Testimony, pp. 15-16, (July 3, 2018).
[225] *In Re: Petition of Tennessee American Water Company For A General Rate Increase*, TPUC Docket 10-00189, *Final Order*, p. 127-128 (April 27, 2012).
[226] James Vander H. Weide, Ph. D., Pre-Filed Direct Testimony, pp. 42-49, (February 15, 2018). Christopher C. Klein, Ph.D., Pre-filed Direct Testimony, p.16 (July 3, 2018).
[227] *See* CGC's Updated Responses to MFG 17, (August 28, 2018). The decision was reached by the Illinois Commission to keep the previously authorized 9.8% equity return. *See Northern Illinois Gas Company d/b/a Nicor Gas Company*, Ill C.C. Docket No. 17-0124, *Order*, (January 31, 2018).

M. REVENUE DEFICIENCY

Based upon the rate base, net operating income, fair rate of return, and the revenue conversion factor adopted by the panel, the panel determined that the revenue deficiency for CGC is $1,390,347 for the attrition period.

N. RATE DESIGN

The goal of overall rate design is to establish a system of rates that will enable a utility to generate sufficient revenues to cover expenses needed to operate the utility, plus an equity return for investors. There are often, however, many factors that are taken into consideration when designing rates, including those related to economics and social considerations. Social considerations may require affordable rates for certain customer classes that are less reflective of the actual cost of service. Economic considerations may include federal and state legislation that has been enacted to encourage energy efficiency and energy conservation and tasked state commissions with exploring rate design alternatives to align the conservation interests of consumers, while providing utilities with the proper financial incentive for promoting energy efficiency and energy conservation.

The Company proposed recovery over $4 million of its requested $6.2 million increase from residential customers and nearly $1 million from small commercial customers.[228] In total, the Company's proposed rate design seeks to recover $5 million of its requested $6.2 increase from these two customer classes. CGC's rate proposal represents a 28.21% increase in residential base rates and small commercial rates. The remaining revenue increase is apportioned to large

[228] CGC has reduced its requested rate increase from $7.0 million to $6.1 million through several modifications, though the latest rate design provided by the Company is based upon a requested revenue increase of 6.2 million. Daniel P. Yardley, Pre-filed Rebuttal Testimony, pp. 8-9, (August 3, 2018).

commercial, commercial transportation and industrial customers in CGC's proposed rate design.[229]

Specifically, CGC proposed a $5.00 increase to the Residential monthly fixed charge for November through April and a $5.50 increase to the same charge for May through October. For Small Commercial monthly rates, both the winter and summer fixed rates would increase by $10.00 per month. The other customer classes will retain their current fixed monthly rate.[230]

In addition, CGC would increase the fixed demand charge for Medium Commercial and Industrial customers by $1.5 per dekatherm, and the seasonally differentiated declining block variable distribution charge will increase by $0.01093 per therm. Further, the larger Industrial customer's fixed monthly demand charge would also increase by $1.50 per dekatherm, and the partial standby monthly demand charge will increase by $0.40 per month. The declining block variable distribution charges will increase by $0.00022 per therm.[231]

Company witness Daniel Yardley recommends these rates based upon a class cost of service study ("ACOSS") he performed.[232] His cost of service study indicates that residential and small commercial customers' rates do not cover their respective costs. Mr. Yardley testified that the rate design should be reflective of the service received in order to promote efficient energy consumption and to prevent overuse of a natural resource due to availability subsidized by other customers. In order to provide more intra-class fairness, Mr. Yardley proposed to allocate the largest portion of the requested revenue increase to Residential and Small Commercial rate classes.[233]

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[229] *Id.*
[230] Daniel P. Yardley, Pre-filed Direct Testimony, p. 17 (February 15, 2018).
[231] *Id.* at 19.
[232] *Id.* at 2.
[233] *Id.* at 3, 12-16.

Mr. Yardley also testified that when the variable portion of the rate is set to recover fixed costs, the Company is encouraged to promote increased consumption by customers. He stated that CGC rates currently follow the traditional throughput rate design, and a significant portion of base distribution revenues are derived from the variable portion of the rate.[234] Accordingly, CGC proposed allocating its proposed revenue increase predominantly to fixed monthly charges, explaining that the fixed customer charge is an important element of customer rates for three reasons: (1) it sends a price signal to the customer about the cost of connecting to the gas system; (2) it results in fairness to all customers; and (3) it provides revenue stability to the Company to recover the fixed cost to serve.[235]

The Consumer Advocate argued that the Company's Class Cost of Service Study ("CCOSS") is one factor to consider when evaluating the rates for each customer class as it established a cost for serving each of the separate customer classes and offered an allocation method to distribute the cost to the classes without providing evidence to explain rationale for allocations.[236] Mr. Novak challenged the impartiality of the Company's CCOSS and contended that distribution of the 41 allocation factors is "inherently judgmental."[237] Mr. Novak also pointed out, as an example, that many of the allocation factors are based on peak day consumption, instead of total throughput, which will assign almost all of these costs to residential and small commercial customers. He further stated that the Company has not substantiated the appropriateness of the factors used and asserted that other factors that should be considered when allocating costs to customer classes, such as the value of service that cannot be mathematically

[234] *Id.* at 4-5.
[235] *Id.* at 15-17.
[236] William H. Novak, Pre-filed Direct Testimony, pp. 31-32, (July 3, 2018).
[237] *Id.* at 32.

quantified. Mr. Novak also testified that a CCOSS should not be directly converted into rates and such studies have never been adopted by the Commission for the purpose of setting rates.[238]

Rather than utilize a cost of service study on which to base rates, the Consumer Advocate instead recommended that its proposed rate reduction be allocated evenly across-the-board to each customer class, including special contract customers, based on the ratio of each customer class' attrition period margin to the total attrition period margin.[239] The Consumer Advocate argued that across-the-board changes in rates more equitably spreads the benefit or burden of rate changes and is preferable to the basing rates upon a CCOSS as CGC proposed. Based upon the Consumer Advocate's recommended rate reduction, the across-the-board rate decrease would be 8.9% to all customer classes.[240]

Although the panel considered CGC's cost of service study to be a useful tool, the panel agreed with the concerns raised by the Consumer Advocate with regard to the lack of an in-depth analysis of the Company's cost of service study and the allocations within the study. The panel noted that the peak day allocations relied upon by the Company have been the subject of much debate among state commissions, gas utilities and consumer advocacy groups. Without a full analysis of all inputs and assumptions used in cost of service model, the panel cannot rely upon the results of the Company's cost of service study as being truly representative of actual costs for customer classes. However, the panel found the Company's cost of service study to provide some generalities that have merit, such as residential and small commercial classes providing less margin than large commercial, industrial and transportation classes. The panel found that by themselves, the generalities supported by the cost of service study are not a just and reasonable basis for the shifting of approximately 82% of cost recovery to the residential and small

[238] *Id.* at 32-33.
[239] *Id.* at 33.
[240] *Id.* at 34.

commercial classes with much smaller increases to large industrial and interruptible customers as proposed by CGC. For this reason, the panel rejected the Company's rate design methodology which is based upon its class cost of service study.

The panel observed that with a significant portion of revenues collected through volumetric charges, along with the fact that customer usage is declining, it has become increasingly difficult for all local distribution gas companies, including CGC, to maintain a revenue stream sufficient to earn its authorized rate of return. In addition, the panel found that CGC has no incentive to encourage customers to use less gas and, in fact, CGC is actually incentivized to sell more gas in order to generate additional revenues to increase earnings. In order to break the link of fixed cost recovery through volumetric charges, the panel determined it is necessary to approve and implement a rate design consisting of rate increases to fixed monthly charges and fixed demand charges. Such a design allows recovery of fixed costs through revenues that are more stable and predictable than those revenue streams collected via volumetric usage, which may vary greatly depending on weather and overall decline in customer usage due in part to more efficient appliances and homes, programmable thermostats and improving general customer awareness.

Based upon the panel's decisions regarding rate design, the panel voted unanimously to increase: the Residential R-1 Class fixed monthly rate from $13.00 to $14.00 in the summer and from $16.00 to $17.00 in the winter; the Residential R-4 Class fixed summer and winter monthly rates from $6.00 to $6.25; the Commercial C-1 fixed monthly rate from $25.00 to $26.80 in the summer and from $29.00 to $31.00 in the winter; and, the Firm Demand Charge from $5.50 to $6.35 for the Commercial C-2 Class, the Commercial Transportation Class, and the Industrial Transport with Full Standby and Partial Standby Classes. The panel found that these rate changes

for revenue recovery are consistent with state and federal legislation regarding aligning the financial interest of the utility with the consumer interests of energy conservation and energy efficiency.

O. SPECIAL CONTRACT CHARGES

As indicated in above the Consumer Advocate argued for a rate design that allocated an evenly proportioned reduction (or increase) across-the-board for all classes, including special contracts.[241] The Consumer Advocate presented evidence that subsequent to Commission approval of a Special Contract between Chattanooga Gas and E.I. DuPont de Nemours in TPUC Docket No. 99-00908,[242] the Company has given these rates to subsequent owners of this plant by assignment of the special contract without seeking approval from the Commission.[243] The Company responded indicating approval was not necessary, the special contract contained language binding successors, and the Commission was aware of the assignment through subsequent dockets.[244] While the panel did not adopt a rate change applicable to the special contract, the panel voted unanimously to direct the Company, if the special contract is to be renewed or extended, to file for approval of this contract no less than 90 days prior to its current expiration, and to provide documentation that such contract is consistent with Commission Rules and remains in the public interest.

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[241] William H. Novak, Pre-filed Direct Testimony, pp. 31-32, (July 3, 2018).
[242] *In Re: Application of Chattanooga Gas Company for Approval of Negotiated Contract with E.I. Du Pont De Nemours Company*, TPUC Docket No. 99-00908, *Order Approving Application for Approval of Negotiated Contract with E.I. Du Pont De Nemours Company*, (July 18, 2000).
[243] *Id.* at 12-13.
[244] Archie R. Hickerson, Pre-filed Rebuttal Testimony, pp. 10-12, (August 3, 2018). *See also* Transcript of Hearing, Vol. II C, pp. 227-228, (August 21, 2018).

P. TARIFF CHANGES

P(1). MISCELLANEOUS CHANGES

The Company proposed certain changes to the current tariff through its witness Archie Hickerson. First, CGC proposes to replace the 12 page standard line extension provision and its 28 page Appendix with a simpler provision more in-line with other gas companies in Tennessee.[245] As another revision to the tariff, a new residential customer using gas for central heat and water heating will now qualify for up to 100 feet of service line installed at no charge. The Company will not be changing how they determine the amount of investment needed based on projected revenue; however, the tax gross-up factor has been revised to 17.25% to reflect the new 21% corporate tax rate and is on sheet 51 on Commission Tariff No. 1 and sheet 8 on Commission Tariff No. 2.[246]

Mr. Hickerson also testified that several deletions are needed in the current rate schedules to eliminate classes that are unused or see little use. CGC proposed elimination of the special R-1 Air Conditioning, as there are no Residential Air Conditioning customers.[247] Similarly, Rate Schedule SF-1 would be deleted, as there no customer has ever been provided service under this schedule.[248] Finally, CGC would also eliminate the Standby Demand Charge for Rate Schedules R-1, R-4, and C-1, as there are only 11 customers currently being billed this charge, making the billing process cost ineffective administratively.[249]

In addition, CGC proposed revising its tariff to add language for the protection of its employees and agents. This revision would authorize the Company to discontinue service to a customer if the Company has reasonable evidence that there may be a danger from the customer,

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[245] Archie R. Hickerson, Pre-filed Revised Direct Testimony, pp. 4-5, (May 1, 2018).
[246] *Id.*
[247] *Id.* at 5.
[248] *Id.* at 6.
[249] *Id.* at 5.

or anyone on the customer's premises, to Company personnel or agents who are on the premises on Company business.[250]

CGC is also proposing a revision that will allow the Company to determine the receipt point when the Company is not able to deliver gas directly to the customer and a solution cannot be found through displacement.[251] Mr. Hickerson also described revisions to the Performance Based Ratemaking provision of the tariff concerning the separate reporting of certain gas purchases and the replacement of certain benchmarks and indexes.[252]

The panel found that there was no opposition testimony to these proposed tariff changes from either the Consumer Advocate or the CRMA. Further, the panel found that these changes had little or no impact to customers and that the proposed tariff change concerning contributions for aid in construction is consistent the 2017 Tax Cuts and Jobs Act. Accordingly, the panel voted unanimously to approve each of the above described tariff revisions.

P(2). UNAUTHORIZED GAS USE PENALTY TARIFF

The Company also proposed increasing the Unauthorized Gas Use Penalty to make it significant enough to deter customers from continuing to use gas beyond the amount delivered to the Company for them or beyond their contracted volumes. CGC would also revise the tariff to state that the Company may terminate services to the customer that continues the excessive use of gas beyond their allotted amount.[253]

Randy Carter, manager of Talley Construction Company ("Talley"), presented testimony on behalf of CRMA expressing concern over the proposed change in the Company's Unauthorized Gas Use Penalty, stating the changes would result in "unreasonable hardship" for

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[250] *Id.* at 8.
[251] *Id. at 7.*
[252] *Id.* at 7-8.
[253] *Id.* at 6-7.

Talley's three asphalt facilities in Chattanooga and Cleveland, which are billed under class Chattanooga T-1.[254] Mr. Carter testified that the variable nature of the day to day demand for natural gas coupled with a recent change in CGC's practices on the issuance of daily balancing orders has made it very difficult for Talley to avoid penalties despite its efforts to anticipate usage requirements.[255] Mr. Carter gave testimony concerning one specific instance wherein an unusually warm December day in 2017 resulted in larger than normal demand for asphalt. As a result, Talley overdrew 437.7 (Dth) at a penalty rate of $15.00, for a total penalty charge of $6,565.50, on a day when the gas price was relatively low at only $2.73.[256] Further, Mr. Carter objected to the CGC's discontinuance of the sale of incremental gas to interruptible customers as an alternative to paying penalty rates, as the Company did not seek agency approval for such discontinuance.[257]

The panel found that the testimony presented by the CRMA provides evidence that the significant increase found in proposed revision to the Unauthorized Gas Use Penalty Tariff is not reasonable. Further, the panel found that the Company failed to provide sufficient justification for the amount of the increase of the penalty. Therefore, the panel unanimously voted to deny approval of the proposed revision to the Unauthorized Gas Use Penalty Tariff.

Q. LNG Accounting Methodology

The Consumer Advocate discovered a change in accounting methodology for the sales of Liquefied Natural Gas ("LNG") from the facility in Chattanooga. Mr. Novak testified that the Company's Interruptible Margin Credit Rider ("IMCR") allows the margin from off-system sales to be shared on a 50/50 basis with its customers. While the margin of these sales was recorded on

[254] Randy Carter, Pre-filed Direct Testimony, pp. 2-3, (July 3, 2018).
[255] *Id.* at 4.
[256] *Id.* at 4-5.
[257] *Id.* at 5-6.

the Company's books up until July of 2010, subsequent to that date, Mr. Novak stated the Company made an accounting change where only the gas cost of LNG is recorded on the books and the margin is kept on an affiliate's books to be shared with customers through the IMCR.[258] Mr. Novak testified that because the affiliate may not always be the asset manager of the LNG sales the Commission should require the Company to record both the gas cost and the margin from LNG sales on its books.[259] Further, he recommended that the 50% that is shared from this margin with the customers should be increased to 75%, as the customers should receive a larger portion of the benefits since they cover all of the cost from the LNG sales and the Commission has approved[260] the same percentage in another docket.[261]

Company witness Hickerson rebutted that the Commission did not adopt a 25/75 sharing percentage in TPUC Docket No. 07-00224[262] involving CGC.[263] Mr. Hickerson further testified that changing the sharing ratio risks loss of the LNG sales to another facility, and hence reduction of or loss of refunds to CGC's on-system customers.[264]

The panel found that a docket establishing base rates is not the appropriate venue to resolve this particular issue. Therefore, the panel voted unanimously to direct Commission Staff and any interested party to fully analyze and investigate this matter during an appropriate future proceeding.

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[258] William H. Novak, Pre-filed Direct Testimony, pp. 13-14, (July 3, 2018).
[259] *Id.* at 15.
[260] *In Re: Review of Nashville Gas Company's Incentive Plan Account Relating to Asset Management Fees*, TPUC Docket No. 05-00165, *Order Approving Settlement*, p. 2, (December 14, 2007).
[261] *Id.* at 14-15.
[262] *In Re: Docket to Evaluate Chattanooga Gas Company's Purchaes and Related Sharing Incentives*, TPUC Docket No. 07-00224, *Order*, (September 23, 2009).
[263] Archie R. Hickerson, Pre-filed Revised Rebuttal Testimony, p. 17, (May 1, 2018).
[264] *Id.*

R. ELIMINATION OF THE AUA AND REINSTATEMENT OF THE WNA

R(1). PROCEDURAL HISTORY OF THE IMPLEMENTATION AND EXPERIMENTAL PERIOD OF THE AUA

In its 2009 rate case in TPUC Docket 09-00183, CGC requested a rate design that incorporated the effects of weather and other factors of customer use, including energy conservation.[265] The Alignment and Usage Adjustment ("AUA") mechanism was a "revenue decoupling" mechanism intended to allow CGC the opportunity to earn a fair rate of return while promoting energy conservation. The AUA was proposed by the Company in tandem with an energy conservation program to educate and encourage energy conservation and provide tools, such as programmable thermostats, to Tennessee customers to help them use less natural gas. The Company sought to eliminate the WNA, as the AUA would account for any change in customer usage for all factors, including weather.[266]

The Company's proposal was an attempt to answer the call of the Tennessee General Assembly to align the financial interests of public utilities with energy conservation.

> The general assembly declares that the policy of this state is that the Tennessee public utility commission will seek to implement, in appropriate proceedings for each electric and gas utility, with respect to which the commission has rate making authority, a general policy that ensures that utility financial incentives are aligned with helping their customers use energy more efficiently and that provides timely cost recovery and a timely earnings opportunity for utilities associated with cost-effective measurable and verifiable efficiency savings, in a way that sustains or enhances utility customers' incentives to use energy more efficiently.

Tenn. Code Ann. § 65-4-126. While there was general consensus regarding the importance of energy conservation among the parties in the Company's 2009 rate case, there was considerable

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[265] *In Re: Petition of Chattanooga Gas Company for a General Rate Increase, Implementation of the EnergySmart Conservation Programs and Implementation of a Revenue Decoupling Mechanism*, Docket 09-00183, (hereafter "*2009 Chattanooga Gas Rate Case*"), *Final Order*, pp. 50-52, (November 8, 2010) (hereafter "*2009 Rate Case Order*").

[266] *Id.* at 58-59.

debate as to how to implement the requirements of General Assembly's policy with respect to aligning the financial interests of the Company with crafting energy conservation programs that were cost efficient and able to produce verifiable and measurable savings.[267]

Ultimately, the Commission approved the AUA rider after making the following modifications: (1) the rider only applied to R-1 and C-1 customers; (2) the rider was approved on a three-year experimental basis; and (3) the AUA adjustments were limited, as recommended by the Consumer Advocate, to a cap of 2% of margin revenue annually.[268] In addition, as part of the rate design decision in the 2009 rate case, the Commission determined it was appropriate to allow for approximately 70% of the Company's fixed costs to be recovered via fixed monthly charges and the remainder recovered via volumetric charges, thereby providing a greater amount of revenues that are less dependent upon volumetric billing.[269] In recognition of the reduced business risk inherent in such rate design changes, the Commission adopted a twenty-five basis point reduction in the return on equity.[270]

The Commission also approved a portion of the Company's energy conservation program, consisting of providing programmable thermostats to customers as well as an education and outreach program.[271] The bulk of the conservation measures were funded by consumers.[272] Finally, in an effort to comply with legislative directives that energy conservation programs be cost-effective and provide measurable and verifiable savings, the Commission directed the Commission Staff to work with the National Regulatory Research Institute ("NRRI") to develop a set of measurements to evaluate the approved energy conservation programs. The three-year

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[267] *Id.* at 50-55.
[268] *Id.* at 57.
[269] *Id.* at 56.
[270] *Id.* at 45.
[271] *Id.* at 61.
[272] *Id.*

experimental period was to be followed by a review of the impact of both the AUA and the approved energy conservation programs.[273]

As the end of the initial three-year experimental period was coming to a close, on April 25, 2013, the Company filed a motion in TPUC Docket 09-00183 requesting an extension of the experimental period of up to three additional years for the AUA and the energy conservation programs before a review could take place.[274] In addition to the extension, the Company sought to modify the 2% annual cap. The Company claimed that the cap prevented the collection of over $1 million in revenue that would have been collected had the WNA been in effect. The Company asserted an extension was necessary, as the AUA was scheduled to end on May 31, 2013, before the Commission's review. Without an extension of the AUA, the Company's revenues would be impacted by any variance in usage, including weather.[275] The Company also asserted NRRI had not yet completed its work with respect to developing measurements and standards to the energy conservation programs and provided a report to the Commission. The Consumer Advocate opposed any extension without a review of the AUA and the energy conservation programs and argued that the Company may be earning more than its authorized return.[276] On May 16, 2013, Commission Party Staff intervened to participate in the review.[277]

On June 17, 2013, the Commission hearing panel assigned to the docket extended the AUA on an interim basis pending an evidentiary review of the AUA and energy conservation programs.[278] The Commission denied the Company's request to consider modifying the cap

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[273] *Id.* at 57.
[274] *2009 Chattanooga Gas Rate Case, Chattanooga Gas Company's Motion to Extend the Alignment and Usage Adjustment and Conservation Programs Approved by the Authority*, (April 25, 2013).
[275] *Id.* at 2-3.
[276] *2009 Chattanooga Gas Rate Case, Order Extending Alignment and Usage Adjustment Mechanism, Convening a Contested Case Proceeding and Appointing a Hearing Officer*, p. 4 (November 6, 2013).
[277] *2009 Chattanooga Gas Rate Case, Memorandum*, (May 16, 2013).
[278] *Id.* at 5-6.

without an evidentiary hearing.[279] A procedural schedule was established based on a joint proposal by the parties.[280] The schedule was to be triggered by the filing of the Commission's Party Staff report.

After NRRI completed its work and report, the Commission Party Staff analyzed the results and filed its report on September 19, 2017.[281] The scope of the Staff Report was limited to an evaluation of the energy conservation programs, and neither the NRRI nor the Party Staff made any recommendations with respect to the AUA.[282] On October 20, 2017, the Company filed a request to terminate the AUA trial mechanism and reinstatement of the WNA.[283] The Company offered that it was willing to defer consideration of its proposal to address funds deferred under the AUA.[284] On October 24, 2017, the Consumer Advocate submitted the pre-filed testimony of William H. Novak. The Consumer Advocate noted the content of the Staff's Report and NRRI's conclusions that the energy conservation programs were reasonable in intent, but short sighted and difficult to assess and measure any resulting customer savings.[285] The Consumer Advocate opposed reinstatement of the WNA outside of a rate case proceeding and recovery of any deferred AUA amounts captured by the 2% cap.[286]

The parties mutually agreed that the energy conservation programs expired after the end of the three-year experimental period and that the outstanding issues in the 2009 rate case docket

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[279] *Id.*
[280] *2009 Chattanooga Gas Rate Case, Order Entering Amended Procedural Schedule*, (August 9, 2013).
[281] *2009 Chattanooga Gas Rate Case, Staff Report*, (September 19, 2017).
[282] *Id.*; *TPUC Party Staff Response Regarding Chattanooga Gas Company's Report and Recommendations on the Trial AUA*, (October 26, 2017).
[283] *2009 Chattanooga Gas Rate Case, Chattanooga Gas Company Request to Terminate the Trial AUA Mechanism and Reinstate the WNA*, October 20, 2017.
[284] *Id.* at 7.
[285] *2009 Chattanooga Gas Rate Case*, William H. Novak, Pre-filed Direct Testimony, p. 6, (October 24, 2017).
[286] *Id.*

should be moved into the Company's next rate case expected in early 2018.[287] Thereafter, the issues of whether the AUA should be terminated, whether the WNA should be reinstated, and whether CGC is entitled to any recovery of the AUA deferral under-recovery were placed in the present docket for resolution.[288]

R(2). THE AUA AND RELATED ISSUES IN THIS DOCKET

In the present rate case, the Company requested to eliminate the AUA, to reinstate the WNA for residential R-1 and commercial C-1 customers, and to recover approximately $1.9 million of accumulated and deferred AUA adjustments that exceeded the tariff rider's adjustment cap.[289] The Company claimed that, because of the warmer winters experienced over the past few years, coupled with the 2% margin cap on AUA adjustments, R-1 and C-1 customers have received approximately $1.9 million in gas that has not been recouped since inception of the rider.[290] For this reason, the Company has asked to terminate the AUA and return the R-1 and C-1 customers to the WNA, or alternatively, to continue the AUA with the weather normalization recovery moved to the WNA tariff. In either scenario, however, the Company has also requested to recover the $1.9 million of accumulated and deferred AUA adjustments through the Interruptible Margin Credit Rider ("IMCR").[291]

The Company stated that the AUA was meant to allow recovery of costs while encouraging customers to conserve energy. The calculation for the AUA was based on the average revenues per customer for R-1 and C-1 customers each month using approved rates and billing determinants.[292] Monthly averages became benchmarks to which actual revenue amounts

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[287] *2009 Chattanooga Gas Rate Case, Order Moving Outstanding Issues into the New Docket and Administratively Closing the Docket*, pp. 3-4, (January 5, 2018).
[288] *Id.* at 5-6.
[289] Archie R. Hickerson, Revised Pre-filed Direct Testimony, p. 3, (May 1, 2018).
[290] Wendell Dallas, Revised Pre-filed Direct Testimony, pp. 22-23, (May 11, 2018).
[291] *Id.* at 24.
[292] Archie R. Hickerson, Revised Pre-filed Direct Testimony, p. 9-10, (May 1, 2018).

were compared. Amounts collected (actual billed non-gas revenue divided by the number of customers) over the benchmark were subject to be refunded back to customers, and conversely, amounts collected under the benchmark could be surcharged. This calculation was performed monthly and any over/under collected amounts were then recorded in the deferred AUA revenue account.[293]

Mr. Hickerson testified that each year, the deferred AUA revenue account (as of May 31) is evaluated for both the R1 and C1 rate schedules to ascertain the amount of over or under collected funds for the year. Funds under or equal to the 2% margin cap, either to the positive or negative, are then divided by the total therms of gas consumed by the customers in the R-1 and C-1 rate schedule. The result, the AUA factor, is then billed or credited monthly to customers over the next 12 months, called the recovery period. The accumulated balance over the 2% cap is carried over into the next year's AUA factor calculation.[294] Mr. Hickerson stated that the accumulated balance over the 2% cap is approximately $1.9 million as of May 31, 2017.[295]

Mr. Hickerson asserted that the AUA mechanism has not met its objectives or served the best interest of customers or the Company. The Company contended that there is a revenue recovery shortfall for both rate schedules R-1 and C-1.[296] The Company also asserted the funds collected through the AUA for rate schedule R-1 are significantly out of sync each year with the authorized margin. In other words, the difference between the benchmarks and the actual revenues is significant, with large swings from positive to negative in some years. As a result of the 2% cap, the Company is unable to recoup all of its costs each year, which the Company argued is unfair. Finally, Mr. Hickerson also testified that although the C-1 rate schedule AUA

[293] *Id.* at 10-11.
[294] *Id.*
[295] Archie R. Hickerson, Pre-filed Rebuttal Testimony, p. 24, (August 3, 2018).
[296] Archie R. Hickerson, Revised Pre-filed Direct Testimony, p. 13-15, (May 1, 2018

balances have been steadier, the Company still is unable to recover the full cost of service due to the 2% cap.[297]

Consumer Advocate witness Novak addressed the Company's proposal to terminate the AUA and recover the approximately $1.9 million deferred cumulative AUA balance in his testimony. Mr. Novak asserted that, from December 2011 to December 2014, the Company earned about $3.3 million more than its authorized rate of return.[298] He testified that CGC would have continued to exceed its authorized rate in 2015 and 2016 if there had not been a dramatic increase in its rate base of about $14 million. Additionally, Mr. Novak testified that the Commission has not given any authorization for the Company to recover the deferred AUA balance.[299] Therefore, Mr. Novak recommends that the Commission deny the Company's request to recover the deferred AUA balance and conduct an audit of the AUA surcharges and collections.[300]

There is consensus among the parties that the AUA should be terminated. Therefore, the panel voted unanimously to terminate the AUA and reinstate the WNA for the R-1 and C-1 rate classes consistent with the simple regression methodology proposed by the Consumer Advocate. With respect to the Company's request for recovery of the balance of the deferred AUA account, the panel voted unanimously to deny the request.

In considering utility proposals for energy conservation programs and related incentive rate designs, the Commission seeks for a balance in aligning the interests of utilities and customers with the goals of energy conservation.[301] The AUA was designed to adjust for all

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[297] *Id.* at 15-16.
[298] William H. Novak, Pre-filed Direct Testimony, p. 39 (July 3, 2018).
[299] *Id.*
[300] *Id.* at 40.
[301] *In Re: Petition of Piedmont Natural Gas Company, Inc. to Implement a Margin Decoupling Tracker (MDT) Rider and Related Energy Efficiency and Conservation Programs*, TPUC Docket 09-00104, *Order Denying Margin Decoupling Tracker Rider*, pp. 11-18 (June 9, 2010).

factors that impacted the usage volumes and the resulting revenue collected. Gas usage can be impacted by a number of factors, including price volatility in the natural gas commodities market. The AUA looks solely at revenue on a per customer average and ignores any changes in the Company's expenses which can lead to an unreasonable mismatch between revenues and expenses. Without some measure of moderation and protection, revenue decoupling can impact the bills of customers unreasonably beyond policy incentives and the compensation required to offset the effects of an energy conservation program.

In approving the AUA in 2010, the Commission specifically adopted one of the consumer protections proposed by the Consumer Advocate; a 2% annual cap on margin accruals within the AUA mechanism.

> ....At the end of the three year trial period, the Company shall provide a report to the Authority[302] on the AUA mechanism, including its impact and effect on both consumer classes and the Company. The report shall provide recommendations as to whether the AUA mechanism should be continued. Further, the panel voted unanimously to adopt the 2.0% annual cap on margin accruals within the AUA mechanism for the R-1 and C-1 classes, as recommended by the Consumer Advocate.[303]

Thus, concerned with the potential of passing on higher costs associated with the program's conservation and decoupling initiatives, the Commission approved the cap on annual adjustments to limit the impact of the program's costs on customers' bills. The purpose of the cap was to restrict the amount of cost recovery available under the AUA program to an amount deemed reasonable by the Commission.

While the AUA has remained in effect since 2010, the energy conservation programs which were the policy rationales underlying the implementation of the AUA were not extended in 2013 and fell short of the goals set by the legislature. Moreover, review of the Company's

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[302] The Tennessee Public Utility Commission was previously known as the Tennessee Regulatory Authority ("Authority").

[303] *2009 Rate Case Order*, at 57.

earnings since the inception of the AUA program shows that the AUA rider and related cap had little, if any, effect on the Company's ability to achieve its authorized rate of return. Finally, as pointed out by the Consumer Advocate, the Commission specifically prohibited CGC from accruing margin shortfalls above the 2% cap, much less authorizing the recovery of AUA adjustment amounts over the annual 2% cap.[304] The Company never petitioned or obtained an accounting order which would have authorized deferral of these amounts into a regulatory asset for consideration of recovery in a future proceeding. The Company's request in 2013 to enlarge the cap was denied.[305] The record before the panel does not support the retroactive elimination of the cap. Therefore, the panel found that the Company is not entitled to recovery of the balance of the deferred AUA account and as previously indicated hereinabove, the panel unanimously voted to deny the Company's request to recover the deferred AUA balance.

IT IS THEREFORE ORDERED THAT:

1. The rates filed by Chattanooga Gas Company on February 15, 2018 are denied;

2. For purposes of the rates herein, the annual test period shall be the historical test period for the twelve months ending December 31, 2017, with adjustments for attrition for the twelve month period ending June 30, 2019;

3. For purposes of the rates herein, the rate base is $149,739,716 and the net operating income is $9,625,826;

4. For purposes of the rates herein, the capital structure is composed of 44.47% long-term debt, 6.3% short-term debt and 49.23% equity. The cost of capital rates consist of long-term debt cost of 4.73%, short-term debt cost of 3.01% and an equity return of 9.8%;

5. For purposes of the rates herein, the overall rate of return shall be 7.12%;

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[304] The Commission Order states, "The margin accruals within the AUA mechanism for R-1 and C-1 classes shall have a 2.0% annual cap." *Id.* at 66.

[305] *2009 Chattanooga Gas Rate Case, Order Extending Alignment and Usage Adjustment Mechanism, Convening a Contested Case Proceeding and Appointing a Hearing Officer*, p. 5 (November 6, 2013).

6. For purposes of the rates herein, the Revenue Conversion Factor is 1.347169, resulting in a Revenue Deficiency of $1,390,347, the amount needed for the Company to earn a fair return on its investment during the attrition year;

7. The Residential R-1 Class fixed monthly rate shall be $14.00 in the summer and $17.00 in the winter;

8. The Residential R-4 Class fixed summer and winter monthly rates shall be $6.25;

9. The Commercial C-1 Class fixed monthly rate shall be $26.80 in the summer and $31.00 in the winter;

10. The Firm Demand Charge shall be $6.35 for the Commercial C-2 Class, the Commercial Transportation T-3 Class, the Industrial Transport with Full Standby F-1/T-2 Class, and the Industrial Transport with Partial Standby F-1/T-2+T-1Class;

11. The revision to the line extension provisions of the Chattanooga Gas Company Tariff is approved as filed;

12. The revision of the Tariff by deletion of provisions relating to the Air Conditioning Rate, Standby Demand Charge and Rate Schedule SF-1 Experimental Semi Firm Sales Service are approved as filed;

13. The revision of the tariff concerning the determination of the eligible receipt point is approved as filed;

14. The revision of the Performance Based Ratemaking tariff provision is approved as filed;

15. The revision of the Tariff to add language concerning Employee Protection is approved as filed;

16. The revision of the Tariff to increase the Unauthorized Gas Penalty rate is denied;

17. The Alignment and Usage Adjustment is eliminated for Residential R-1 and Commercial C-1 customers;

18. The Weather Normalization Adjustment is reinstated for Residential R-1 and Commercial C-1 customers;

19. If the special contract approved in TPUC Docket No. 99-00908 is to be renewed or extended, Chattanooga Gas Company is directed to file for approval of extension or renewal of the contract no less than ninety (90) days prior to the date of expiration and provide documentation that such consistent with Commission Rules and remains in the public interest;

20. Commission Staff is instructed to, along with any interested party, fully analyze and investigate the accounting methodology for the sales of Liquefied Natural Gas from the facility in Chattanooga during an appropriate future proceeding;

21. Chattanooga Gas Company's request to recover the deferred balance of the Alignment and Usage Adjustment Mechanism is denied;

22. If Chattanooga Gas Company petitions for an alternative regulatory mechanism, the forward-looking methodologies adopted in this Order should be reviewed for appropriateness in the determination of service rates pursuant to such annual rate-setting mechanism;

23. 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; and

24. 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.

Chair Robin L. Morrison, Vice Chair Kenneth C. Hill and Commissioner David F. Jones concur. None dissent.

ATTEST:

Earl Taylor

Earl R. Taylor, Executive Director

ATTACHMENT 1
(Commission Exhibit)

CHATTANOOGA GAS COMPANY
INDEX TO SCHEDULES
For the 12 Months Ending June 30, 2019

	Schedule
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CHATTANOOGA GAS COMPANY
Revenue Deficiency (Surplus)
For the 12 Months Ending June 30, 2019

Line No.		Attrition Year	
1	Rate Base	$ 149,739,716	A/
2	Operating Income At Current Rates	9,625,826	B/
3	Earned Rate Of Return	6.43%	
4	Fair Rate Of Return	7.12%	C/
5	Required Operating Income	10,657,877	
6	Operating Income Deficiency (Surplus)	1,032,051	
7	Gross Revenue Conversion Factor	1.347169	D/
8	**Revenue Deficiency (Surplus)**	$ **1,390,347**	

A/ Commission Exhibit, Schedule 2.
B/ Commission Exhibit, Schedule 5.
C/ Commission Exhibit, Schedule 11.
D/ Commission Exhibit, Schedule 12.

Docket No. 18-00017
Commission Exhibit
Schedule 2

CHATTANOOGA GAS COMPANY
Rate Base
For the 12 Months Ending June 30, 2019

Line No.		Attrition Year A/
	Additions:	
1	Utility Plant in Service	$ 301,415,025
2	Construction Work in Progress	12,457,439
3	Pension & OPEB Assets	0
4	Materials & Supplies	343,442
5	Prepayments	46,803
6	Gas Inventory	9,425,959
7	Deferred Rate Case Expense	1,117,499
8	Working Capital	350,066 B/
9	**Total Additions**	$ **325,156,233**
	Deductions:	
10	Accumulated Depreciation	$ 127,903,439
11	Accumulated Deferred Income Taxes	23,114,266
12	Regulatory Liability - Excess Deferrals	22,177,646
13	Regulatory Liability - Deferred Tax Savings	0
14	Customer Advances for Construction	0
15	Reserve for Uncollectibles	169,708
16	Reserve for Health Insurance	33,409
17	Other Reserves	72,774
18	Customer Deposits	1,612,342
19	Accrued Interest on Customer Deposits	332,933
20	**Total Deductions**	$ **175,416,517**
21	**Rate Base**	$ **149,739,716**

A/ Commission Staff Workpaper - Rate Base Summary
B/ Commison Exhibit, Schedule 3.

CHATTANOOGA GAS COMPANY
Lead Lag Results
For the 12 Months Ending June 30, 2019

Line No.		Commission Staff
1	Revenue Lag	43.76 **A/**
2	Expense Lag	39.01 **B/**
3	Net Lag	4.75
4	Daily Cost of Service	$ 180,221 **B/**
5	**Lead Lag Study**	$ **856,635**
6	Tax Collections Withheld	(506,569) **C/**
7	**Net Cash Working Capital Provided**	$ **350,066**

A/ CGC Response to MFG #72 All Attachments Rev 5-31-2018, tab MJA-1, Schedule 1, Column B
B/ Commission Exhibit, Schedule 4.
C/ CGC Response to CPAD Discovery Request 1-0002(a) revised (April 10, 2018)

CHATTANOOGA GAS COMPANY
Working Capital Expense Lag
For the 12 Months Ending June 30, 2019

Line No.		Amount		Lag	E/	Dollar Days
	Operating & Maintenance Expenses:					
1	Purchased Gas Expense	$ 38,611,525	A/	40.94		$ 1,580,755,852
2	O&M Labor	3,216,717	B/	14.01	F/	45,066,202
3	Pension Expense	22,964	B/	0.00		0
4	Post-Retirement Benefits Other Than Pension	0	B/	0.00		0
5	Miscellaneous Employee Benefits	(312)	B/	4.47		(1,393)
6	401K Benefits	120,978	B/	12.07		1,460,201
7	Health/Life Insurance Expense	573,050	B/	8.98		5,145,989
8	Allocated Cost	3,371,863	B/	21.94		73,978,669
9	Uncollectible Expense	121,863	B/	43.76		5,332,708
10	Other Operating Expense	4,051,519	B/	31.49		127,582,320
	Taxes:					
11	Taxes Other Than Income Tax	3,488,071	C/	171.16	G/	597,018,264
12	State Income Tax - Current	0		37.88		0
13	State Income Tax Deferred	372,213	D/	0.00		0
14	Federal Income Tax - Current	0		37.88		0
15	Federal Income Tax - Deferred	264,062	D/	0.00		0
	Other:					
16	Depreciation Expense	8,035,649	H/	0.00		0
17	Interest on Customer Deposits	96,740	I/	0.00		0
18	Interest Expense - Short Term Debt	283,951	J/	(51.36)		(14,583,745)
19	Interest Expense - Long Term Debt	3,149,672	J/	45.76		144,128,973
20	**Total Working Capital Requirement**	$ **65,780,525**		**39.01**		$ **2,565,884,040**
21	**Daily Working Capital Requirement** $ **180,221**					
22	Return on Equity	6,192,203				
23	**Total Cost of Service**	$ **71,972,727**				

A/ Commission Exhibit, Schedule 6.
B/ Commission Exhibit, Schedule 7.
C/ Commission Exhibit, Schedule 8.
D/ Commission Exhibit, Schedule 9.
E/ CGC Response to MFG #72 All Attachments Rev 5-31-2018, tab MJA-1, Schedule 1, Column B
F/ CGC Response to MFG 72-1; Base Payroll lag, excludes consideration of Incentive Compensation lag.
G/ CGC Response to MFG 72 Revised; "TOT Summary Calculation" tab.
H/ CGC Response to MFG #25-1
I/ CGC Response to MFG #69-6
J/ Commission Exhibit, Schedule 11.

Docket No. 18-00017
Commission Exhibit
Schedule 5

CHATTANOOGA GAS COMPANY
Income Statement at Current Rates
For the 12 Months Ending June 30, 2019

Line No.		Attrition Amount	
	Operating Revenues:		
1	Gas Sales & Transportation Revenues	$ 70,473,655	A/
2	Other Revenues	675,121	B/
3	AFUDC	823,951	B/
4	**Total Operating Revenue**	$ **71,972,727**	
	Operating & Maintenance Expenses:		
5	Purchased Gas Expense	$ 38,611,525	A/
6	Operations & Maintenance - Labor	3,216,717	C/
7	Operations & Maintenance - NonLabor	8,261,924	C/
8	**Total Operating & Maintenance Expenses**	$ **50,090,166**	
	Other Expenses:		
9	Depreciation Expense	$ 8,035,649	D/
10	Interest on Customer Deposits	96,740	E/
11	General Taxes	3,488,071	F/
12	State Excise Taxes	372,213	G/
13	Federal Income Taxes	264,062	G/
14	**Total Other Expenses**	$ **12,256,736**	
15	**Total Operating Expenses**	$ **62,346,902**	
16	**Utility Operating Income**	$ **9,625,826**	

A/ Commission Exhibit, Schedule 6.
B/ Commission Staff Workpaper - Revenue Summary
C/ Commission Exhibit, Schedule 7.
D/ CGC Response to MFG #25-1
E/ CGC Response to MFG #69-6
F/ Commission Exhibit, Schedule 8.
G/ Commission Exhibit, Schedule 9.

CHATTANOOGA GAS COMPANY
Revenue Summary
For the 12 Months Ending June 30, 2019

Line No.	Customer Class	Commission Staff A/
	Sales & Transportation Margin:	
1	Residential (R-1)	$ 14,251,629
2	Multi-Family Housing (R-4)	28,029
3	Commercial (C-1)	3,495,831
4	Commercial (C-2)	8,254,355
5	Industrial (F-1/T-2)	2,004,732
6	Industrial (I-1)	36,274
7	Industrial (T-1)	1,082,153
8	Industrial (T-1/T-2)	1,290,946
9	Industrial (T-3)	1,276,880
10	Special Contract	141,302
11	**Total Margin**	$ **31,862,130**
12	Gas Cost	38,611,525
13	**Total Revenue**	$ **70,473,655**

A/ Commission Staff Workpaper - Revenue Summary

CHATTANOOGA GAS COMPANY
O&M Expense Summary
For the 12 Months Ending June 30, 2019

Line No.	Expense		Commission Staff	
1	Payroll Expense	$	$ 3,216,717	B/
2	Employee Benefits		$ 716,680	
3	Benefits Capitalized		$ (92,484)	C/
4	Fleet Services & Facilities Expense		$ 810,419	
5	Outside Services		$ 1,849,778	
6	Bad Debt Expense		$ 121,863	
7	Sales Promotion Expense		$ -	D/
8	Customer Service & Account Expense		$ 4,859	
9	Administrative & General Expense		$ 951,611	
10	Admin & Gen. Salaries & Exp. Capitalized		$ (60,878)	
11	Other Distribution & Storage Expense		$ 588,213	
12	AGL Service Company Allocations		$ 3,371,863	
13	**Total O&M Expense**	$	**11,478,640**	

A/ Commission Staff Workpaper - Expense Summary
B/ Payroll Worksheet 44 Employees, 50% Incentive Comp disallowed
C/ Used CAPD Test period Capitalized percentage applied to Staff Total Benefit amount
D/ Commission Rule 1220-04-05-.45 prohibits the recovery of Advertising and Promotional Expense

CHATTANOOGA GAS COMPANY
Taxes Other than Income Income Taxes
For the 12 Months Ending June 30, 2019

Line No.		Commission Staff	A/
1	Property Taxes	$ 2,093,447	
2	Commission Inspection Fee	305,345	
3	Payroll Taxes	383,805	
4	Franchise Tax	136,334	
5	Gross Receipts Tax	569,140	
6	Allocated & Other Taxes	0	
7	**Total**	$ **3,488,071**	

A/ Commission Staff Workpaper - TOTI Summary

CHATTANOOGA GAS COMPANY
Excise and Income Taxes
For the 12 Months Ending June 30, 2019

Line No.		Commission Staff	
1	**Operating Revenues**	$ **71,972,727**	A/
	Operating Expenses:		
2	Purchased Gas Expense	$ 38,611,525	A/
3	O&M Expenses	11,478,640	A/
4	Depreciation Expense	8,035,649	A/
5	Interest on Customer Deposits	96,740	A/
6	General Taxes	3,488,071	A/
7	**Total Operating Expenses**	$ **61,710,626**	
8	**NOI Before Excise and Income Taxes**	$ **10,262,101**	
9	AFUDC	(823,951)	A/
10	Interest Expense	(3,433,623)	B/
11	**Net Income Before Income Taxes**	$ **6,004,527**	
	Tennessee Excise Tax Calculation:		
12	Net Income Before Income Taxes	$ 6,004,527	
13	Excise Tax Rate	6.50%	
14	**Excise Tax Expense**	$ **390,294**	
15	Less After-Tax Excess Deferred Tax Liability Amortization	18,081	D/
16	**Net Excise Tax Expense**	$ **372,213**	
17	**Excise Tax - Current**	$ **0**	E/
18	**Excise Tax - Deferred**	$ **372,213**	E/
	Federal Income Tax Calculation:		
19	Net Income Before Income Taxes	$ 6,004,527	
20	Net Excise Tax Expense	372,213	
21	**Net Income Before Federal Income Tax**	$ **5,632,314**	
22	FIT Rate	21.00%	
23	**Federal Income Tax Expense**	$ **1,182,786**	
24	Less After-Tax Excess Deferred Tax Liability Amortization - Protected	(21,351)	C/
25	Less After-Tax Excess Deferred Tax Liability Amortization - Tax Cut & Jobs Act	(897,373)	F/
26	Less 2018 Tax Savings Amortization		
27	**Net Federal Income Tax Expense**	$ **264,062**	
28	**Federal Income Tax - Current**	$ **0**	E/
29	**Federal Income Tax - Deferred**	$ **264,062**	E/

A/ Commission Exhibit, Schedule 5.
B/ Commission Exhibit, Schedule 11.
C/ MFG 61-2 Line 28 State
D/ MFG 61-2 Line 28 Federal
E/ All Pre-tax book income assumed to be deferred.
F/ MFG 69 Rev 5-31-2018

CHATTANOOGA GAS COMPANY
Income Statement at Proposed Rates
For the 12 Months Ending June 30, 2019

Line No.		Current Rates A/	Rate Increase	Proposed Rates
	Operating Revenues:			
1	Gas Sales & Transportation Revenues	$ 70,473,655	$ 1,390,347 B/	$ 71,864,002
2	Other Revenues	675,121	12,230	687,351
3	AFUDC	823,951	0	823,951
4	**Total Operating Revenue**	$ **71,972,727**	$ **1,402,577**	$ **73,375,304**
	Operating & Maintenance Expenses:			
5	Purchased Gas Expense	$ 38,611,525	$ 0	$ 38,611,525
6	Operations & Maintenance - Labor	3,216,717	0	3,216,717
7	Operations & Maintenance - NonLabor	8,261,924	5,364	8,267,288
8	**Total Operating & Maintenance Expenses**	$ **50,090,166**	$ **5,364**	$ **50,095,530**
	Other Expenses:			
9	Depreciation Expense	$ 8,035,649	$ 0	$ 8,035,649
10	Interest on Customer Deposits	96,740	0	96,740
11	General Taxes	3,488,071	0	3,488,071
12	State Excise Taxes	372,213	90,819	463,032
13	Federal Income Taxes	264,062	274,344	538,406
14	**Total Other Expenses**	$ **12,256,736**	$ **365,163**	$ **12,621,898**
15	**Total Operating Expenses**	$ **62,346,902**	$ **370,527**	$ **62,717,428**
16	**Utility Operating Income**	$ **9,625,826**	$ **1,032,050**	$ **10,657,876**

A/ Commission Exhibit, Schedule 5.
B/ Commission Exhibit, Schedule 1.

CHATTANOOGA GAS COMPANY
Rate of Return Summary
For the 12 Months Ending June 30, 2019

Line No.	Class of Capital	Commission Staff Percent of Total	Commission Staff Cost Rate	Commission Staff Weighted Cost Rate A/
1	CGC Short-Term Debt	6.30%	3.01%	0.19%
2	CGC Long-Term Debt	44.47%	4.73%	2.10%
3	Common Equity	49.23%	9.80%	4.82%
4	**Total**	**100.00%**		**7.12%**

	Interest Expense Short-Term Debt:		
7	Rate Base	$	149,739,716 B/
8	Short-Term Debt Cost		0.19%
9	**Short-Term Debt Interest Expense**	$	**283,951**
	Interest Expense Long-Term Debt:		
10	Rate Base	$	149,739,716 B/
11	Long-Term Debt Cost		2.10%
12	**Long-Term Debt Interest Expense**	$	**3,149,672**
13	**Total Interest Expense**	$	**3,433,623**

A/ Commission Staff Workpaper - Rate of Return Summary
B/ Commission Exhibit, Schedule 2.

CHATTANOOGA GAS COMPANY
Revenue Conversion Factor
For the 12 Months Ending June 30, 2019

Line No.		Amount	Balance
1	Operating Revenues		1.000000
2	Add: Forfeited Discounts	0.008796 **A/**	0.008796
3	Balance		1.008796
4	Uncollectible Ratio	0.003825 **B/**	0.003858
5	Balance		1.004938
6	State Excise Tax	0.065000 **C/**	0.065321
7	Balance		0.939617
8	Federal Income Tax	0.210000 **C/**	0.197320
9	Balance		0.742298
10	Revenue Conversion Factor (Line 1 / Line 9)		**1.347169**

A/ Commission Staff Workpaper - Other Revenues
B/ Commission Staff Workpaper - Uncollectible Ratio.
C/ Statutory Rates.

CHATTANOOGA GAS COMPANY
Commission Proposed Margin Change
For the 12 Months Ending June 30, 2019

Line No.	Customer Class	Current Rates A/	Proposed Rates	Margin Change B/	Percent Change
1	Residential (R-1)	$ 14,251,629	$ 14,945,883	$ 694,254	4.87%
2	Multi-Family Housing (R-4)	28,029	28,579	550	1.96%
3	Commercial (C-1)	3,495,831	3,648,001	152,170	4.35%
4	Commercial (C-2)	8,254,355	8,592,933	338,578	4.10%
5	Industrial (F-1/T-2)	2,004,732	2,114,123	109,391	5.46%
6	Industrial (I-1)	36,274	36,274	0	0.00%
7	Industrial (T-1)	1,082,153	1,082,153	0	0.00%
8	Industrial (T-1/T-2)	1,290,946	1,333,342	42,396	3.28%
9	Industrial (T-3)	1,276,880	1,329,837	52,957	4.15%
10	Special Contract	141,302	141,302	0	0.00%
11	**Total Sales & Transportation Margin**	**$ 31,862,130**	**$ 33,252,477**	**$ 1,390,297**	**4.36%**
12	Other Revenues	675,121	687,351	12,230	1.81%
13	**Total Margin**	**$ 32,537,251**	**$ 33,939,828**	**$ 1,402,577**	**4.31%**

A/ Commission Exhibit, Schedule 6.
B/ Commission Exhibit, Schedule 10.

ATTACHMENT 2
(Rate Design)

Description	Post Test Year Billing Units Winter Nov-April	Summer May-Oct	Total	Present Winter Rates Nov - April Rate	Revenue	Present Summer Rates May - Oct Rate	Revenue	Present Total Revenue	Proposed Winter Rates Nov - April Rate	Revenue	Proposed Summer Rates May - Oct Rate	Revenue	Proposed Total Revenue
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	(l)	(m)	(n)
Residential (R-1)													
Number of Bills	350,470	343,784	694,254	$16.00	$5,607,520	$13.00	$4,469,192	$10,076,712	$17.00	$5,957,990	$14.00	$4,812,976	$10,770,966
Distribution Charges			36,018,609	$0.11591		$0.11591		$4,174,917	$0.11591	$0	$0.11591	$0	$4,174,917
Total Residential (R-1) Margin					$5,607,520		$4,469,192	$14,251,629		$5,957,990		$4,812,976	$14,945,883
										Residential R-1 Revenue Increase			**$694,254**
										Total % R-1 Increase			**4.87%**
Residential (R-4)													
Number of Bills	1,095	1,107	2,202	$6.00	$6,570	$6.00	$6,642	$13,212	$6.25	$6,844	$6.25	$6,919	$13,763
Distribution Charges	53,177	16,749	69,926	$0.21768	$11,576	$0.19350	$3,241	$14,817	$0.21768	$11,576	$0.19350	$3,241	$14,817
Total Residential (R-4) Margin					$18,146		$9,883	$28,029		$18,419		$10,160	$28,579
										Residential R-4 Revenue Increase			**$551**
								$14,279,657					
										Total % R-4 Increase			**1.93%**

	Post Test Year Billing Units			Present Winter Rates		Present Summer Rates		Present	Proposed Winter Rates		Proposed Summer Rates		Proposed
	Winter	Summer		Nov - April		May - Oct		Total	Nov - April		May - Oct		Total
	Nov-April	May-Oct	Total	Rate	Revenue	Rate	Revenue	Revenue	Rate	Revenue	Rate	Revenue	Revenue
Commercial (C-1)													
Number of Bills	40,822	39,181	80,003	$29.00	$1,183,838	$25.00	$979,525	$2,163,363	$31.00	$1,265,482	$26.80	$1,050,051	$2,315,533
Distribution Charges	6,471,362	891,247	7,362,609	$0.18581	$1,202,444	$0.14589	$130,024	$1,332,468	$0.18581	$1,202,444	$0.14589	$130,024	$1,332,468
Total Commercial (C-1) Margin					$2,386,282		$1,109,549	$3,495,831		$2,467,926		$1,180,075	$3,648,001
										Total C-1 Revenue Increase			**$152,170**
										Total % C-1 Increase			**4.35%**
Commercial (C-2)													
Number of Bills	10,746	10,540	21,286	$75.00	$805,950	$75.00	$790,500	$1,596,450	$75.00	$805,950	$75.00	$790,500	$1,596,450
DDDC (Firm) Demand (C-2) in Dths			395,134	$5.50		$5.50		$2,173,235	$6.35		$6.35		$2,509,098
Distribution Charges													
0 - 3000 therms	14,754,450	5,357,351	20,111,801	$0.18744	$2,765,574	$0.14717	$788,441	$3,554,015	$0.18744	$2,765,574	$0.14717	$788,441	$3,554,015
3,001 - 5,000 therms	1,754,660	637,118	2,391,778	$0.17109	$300,205	$0.11683	$74,434	$374,639	$0.17109	$300,205	$0.11683	$74,434	$374,639
5,001 - 15,000 therms	2,291,486	832,040	3,123,526	$0.16666	$381,899	$0.10892	$90,626	$472,525	$0.16666	$381,899	$0.10892	$90,626	$472,525
over 15,000 therms	733,407	266,301	999,708	$0.08623	$63,242	$0.08623	$22,963	$86,205	$0.08623	$63,242	$0.08623	$22,963	$86,205
Economic Development Discounts								-$2,714		$0		$0	$0
Total Commercial (C-2) Margin					$4,316,870		$1,766,965	$8,254,355		$4,316,870		$1,766,965	$8,592,933
										Total C-2 Revenue Increase			**$338,578**
										Total % C-3 Increase			**4.10%**
Commercial Transportation (T-3)													
Number of Bills	287	289	576	$75.00	$21,525	$75.00	$21,675	$43,200	$75.00	$21,525	$75.00	$21,675	$43,200
DDDC (Firm) Demand (T-3) in Dths			62,302	$5.50		$5.50		$342,663	$6.35		$6.35		$395,620
Distribution Charges													
0 - 3000 therms	1,023,915	581,256	1,605,171	$0.18744	$191,923	$0.14717	$85,543	$277,466	$0.18744	$191,923	$0.14717	$85,543	$277,466
3,001 - 5,000 therms	536,975	304,830	841,805	$0.17109	$91,871	$0.11683	$35,613	$127,484	$0.17109	$91,871	$0.11683	$35,613	$127,484
5,001 - 15,000 therms	1,567,229	889,684	2,456,913	$0.16666	$261,194	$0.10892	$96,904	$358,099	$0.16666	$261,194	$0.10892	$96,904	$358,099
over 15,000 therms	946,638	537,387	1,484,025	$0.08623	$81,629	$0.08623	$46,339	$127,967	$0.08623	$81,629	$0.08623	$46,339	$127,967
Revenue Adjustment													$0
Total Commercial Transportation (T-3) Margin					$648,142		$286,075	$1,276,880		$648,142		$286,075	$1,329,837
										Total T-3 Revenue Increase			**$52,957**
										Total % T-3 Increase			**4.15%**

	Post Test Year Billing Units			Present Winter Rates Nov - April		Present Summer Rates May - Oct		Present Total	Proposed Winter Rates Nov - April		Proposed Summer Rates May - Oct		Proposed Total
	Winter Nov-April	Summer May-Oct	Total	Rate	Revenue	Rate	Revenue	Revenue	Rate	Revenue	Rate	Revenue	Revenue
Industrial Transport with Full Standby (F-1/T-2)													
Number of Bills	188	186	374	$300.00	$56,400	$300.00	$55,800	$112,200	$300.00	$56,400	$300.00	$55,800	$112,200
DDDC (Firm) Demand (T-2) in Dths			128,696	$5.50		$5.50		$707,827	$6.35		$6.35		$817,219
Distribution Charges													
0 - 15,000 therms			5,425,197	$0.08064		$0.08064		$437,488	$0.08064		$0.08064		$437,488
15,001 - 40,000 therms			6,104,799	$0.06891		$0.06891		$420,682	$0.06891		$0.06891		$420,682
40,001 - 150,000 therms			7,250,462	$0.03908		$0.03908		$283,348	$0.03908		$0.03908		$283,348
over 150,000 therms			1,797,936	$0.02402		$0.02402		$43,186	$0.02402		$0.02402		$43,186
Revenue Adjustment													$0
Total Industrial Transport with Full Standby Margin								$2,004,732		$56,400		$55,800	$2,114,123
										Total F-1/T-2 Revenue Increase			**$109,392**
										Total % F-1/T-2 Increase			**5.46%**
Industrial Transport with Partial Standby (F-1/T-2+T-1)													
Number of Bills	84	84	168	$300.00	$25,200	$300.00	$25,200	$50,400	$300.00	$25,200	$300.00	$25,200	$50,400
Demand in Dths													
DDDC (Firm) Demand (T-2)			49,878	$5.50		$5.50		$274,329	$6.35		$6.35		$316,725
Capacity (Non-Firm) Demand (T-1)			51,584	$1.35		$1.35		$69,639	$1.35		$1.35		$69,639
Total Demand													
Distribution Charges													
0 - 15,000 therms			2,474,062	$0.08064		$0.08064		$199,508	$0.08064		$0.08064		$199,508
15,001 - 40,000 therms			3,433,970	$0.06891		$0.06891		$236,635	$0.06891		$0.06891		$236,635
40,001 - 150,000 therms			7,926,817	$0.03908		$0.03908		$309,780	$0.03908		$0.03908		$309,780
over 150,000 therms			6,272,062	$0.02402		$0.02402		$150,655	$0.02402		$0.02402		$150,655
Revenue Adjustment													
sub-Total Industrial Transport with Partial StandbyMargin								$1,290,946					$1,333,342
										Total F-1/T-2+T-1 Revenue Increase			**$42,396**
										Total % F-1/T-2+T-1 Increase			**3.28%**

	Post Test Year Billing Units			Present Winter Rates Nov - April		Present Summer Rates May - Oct		Present Total	Proposed Winter Rates Nov - April		Proposed Summer Rates May - Oct		Proposed Total
	Winter Nov-April	Summer May-Oct	Total	Rate	Revenue	Rate	Revenue	Revenue	Rate	Revenue	Rate	Revenue	Revenue
Interruptible Sales (I-1)													
Number of Bills	6	6	12	$300.00	$1,800	$300.00	$1,800	$3,600	$300.00	$1,800	$300.00	$1,800	$3,600
Distribution Charges													
0 - 15,000 therms			180,000	$0.08064		$0.08064		$14,515	$0.08064		$0.08064		$14,515
15,001 - 40,000 therms			255,454	$0.06891		$0.06891		$17,603	$0.06891		$0.06891		$17,603
40,001 - 150,000 therms			14,212	$0.03908		$0.03908		$555	$0.03908		$0.03908		$555
over 150,000 therms			0	$0.02402		$0.02402		$0	$0.02402		$0.02402		$0
Revenue Adjustment													$0
Total Interruptible Sales (I-1) Margin								$36,274		$1,800		$1,800	$36,274
										Total I-1 Revenue Increase			**$0**
Interruptible Industrial Transportation (T-1)													
Number of Bills	106	107	213	$300.00	$31,800	$300.00	$32,100	$63,900	$300.00	$31,800	$300.00	$32,100	$63,900
Capacity (Non-Firm) Demand (T-1)			106,079	$1.35		$1.35		$143,207	$1.35		$1.35		$143,207
Distribution Charges													
0 - 15,000 therms			2,671,708	$0.08064		$0.08064		$215,447	$0.08064		$0.08064		$215,447
15,001 - 40,000 therms			3,693,480	$0.06891		$0.06891		$254,518	$0.06891		$0.06891		$254,518
40,001 - 150,000 therms			6,082,145	$0.03908		$0.03908		$237,690	$0.03908		$0.03908		$237,690
over 150,000 therms			6,968,859	$0.02402		$0.02402		$167,392	$0.02402		$0.02402		$167,392
Revenue Adjustment													
sub-Total Interruptible Industrial Transport Margin								$1,082,153		$31,800		$32,100	$1,082,153
										Total I-1 Revenue Increase			**$0**

Total Margin all Classes	$31,720,828		$33,111,124
Other Revenues	$675,121		$675,121
AFUDC	$823,951		$823,951
Special Contract Revenues	$141,302		$141,302
Total	$33,361,202		$34,751,498
		Total Revenue Increase	**$1,390,297**
		Revenue Deficiency	**$1,390,347**
			$50

Consumer Advocate

Attachment 1-11

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Document Title	Reference
10-00189 Final TRA Order 4-27-12	Footnote 4
Re South Central Bell Telephone Co	Footnote 4

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE
April 27, 2012

IN RE:	)	
	)	
PETITION OF TENNESSEE AMERICAN WATER	)	**DOCKET NO.**
COMPANY FOR A GENERAL RATE INCREASE	)	**10-00189**
	)	

FINAL ORDER

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This matter came before Chairman Mary W. Freeman, Director Eddie Roberson and Director Sara Kyle of the Tennessee Regulatory Authority (the "Authority" or "TRA"), the voting panel assigned to this docket, at Authority Conferences held on April 4, 2011 and April 18, 2011, to consider the *Petition of Tennessee American Water Company for a General Rate Increase* ("*Petition*") initially filed on September 17, 2010.[1] In addition, at the August 22, 2011 Authority Conference, the panel considered the appropriate method by which TAWC may recover $275,000 in regulatory expenses, incurred during its previous rate case in Docket No. 08-00039, following reversal of the TRA's decision in that docket by the Court of Appeals on June 7, 2011.[2] Upon consideration of the entire record, including all exhibits and the testimony of the witnesses, the panel concluded that the Company had a revenue deficiency of $5,551,013, which should be recovered through increases in rates charged in all customer classes.[3] These conclusions, as well as the TRA's determinations concerning revenues, expenses, taxes and fees, Net Operating Income, Rate Base, Revenue Conversion Factor, and Rate of Return, are fully discussed below.

I. TRAVEL OF THE CASE

Tennessee American Water Company ("TAWC" or the "Company") filed its *Petition* seeking TRA approval of its proposed increased rates, alleging that "[t]he Company's existing rates and charges will not provide, and cannot be made to provide, sufficient revenues to cover all the costs incurred in providing adequate quality water service including its cost of capital."[4] The Company sought to put into effect "customer rates that will produce an overall rate of return

[1] The *Petition*, proposed tariffs and all pre-filed witness testimony of the Company were withdrawn and re-filed in this docket on September 23, 2010.
[2] The Court of Appeals issued its mandate in the appeal of *Tennessee American Water Co. v. Tenn. Regulatory Auth.*, 2011 WL 334678 (Tenn. Ct. App. Jan. 28, 2011) on June 7, 2011.
[3] A majority of the panel determined that the revenue deficiency was in the amount of $5,551,013 and Director Roberson voted against the majority on the following issues: Salaries and Wages, Utility Plant in Service, Rate of Return-Return on Equity, and Revenue Deficiency.
[4] *Petition*, p. 2 (September 23, 2010).

of 8.38% on a rate base of $125,472,973."[5] According to TAWC, its *Petition* would produce additional gross revenues of approximately $9,984,463 for the attrition period ended December 31, 2011, amounting to a 26.77% increase.[6] Following considerable discovery by the parties, and prior to the hearing, the Company amended the *Petition* to reflect a proposed revenue deficiency of $11,580,683, which would equate to a 31% increase.[7] Nevertheless, during the hearing on March 2, 2011, the Company stated that despite the updated numbers that were developed during the discovery process, "[t]he Company is not requesting more than the $9.9 million that it originally filed for."[8] In support of the *Petition*, TAWC filed extensive exhibits along with the pre-filed testimony of John S. Watson, Michael A. Miller, Sheila A. Miller, James Vander Weide, Patrick Baryenbruch, Paul R. Herbert and Dr. Edward L. Spitznagel, Jr.

TAWC is a public utility as defined in Tenn. Code Ann. § 65-4-101 and is engaged in providing residential, commercial, industrial, and municipal water service, including public and private fire protection service, to the City of Chattanooga and surrounding areas, serving approximately 75,000 customers as of March 31, 2010. The rates of TAWC customers located in Georgia are not regulated by the Public Service Commission of the State of Georgia, but instead are set by the TRA.[9] The Company is a wholly-owned subsidiary of American Water Works Company, Inc. ("AWWC"), which is headquartered in Voorhees, New Jersey. AWWC is the largest water holding company in the United States, providing water and wastewater services to sixteen million people in thirty-five states and two Canadian provinces.[10]

On September 21, 2010, the Consumer Advocate and Protection Division of the Office of the Attorney General (the "Consumer Advocate" or "CAPD") filed a petition to intervene. At a regularly scheduled Authority Conference held on September 27, 2010, the panel voted

[5] *Id.* at 11.
[6] *Id.* at 8.
[7] TAWC's Supplemental Revised Exhibit No. 1, Schedule 1 (February 22, 2011).
[8] Transcript of Proceedings, Vol. III B, p. 123 (March 2, 2011).
[9] *Petition*, p. 1.
[10] *Id.* at 2.

unanimously to convene a contested case proceeding, suspend the effective date of the tariffs, and appoint Chairman Freeman as Hearing Officer for the purpose of preparing this matter for hearing, including handling preliminary matters and establishing a procedural schedule to completion.[11] The Chattanooga Regional Manufacturers Association (the "CRMA") and the City of Chattanooga (the "City") filed petitions to intervene on October 4, 2010 and October 6, 2010, respectively. On October 12, 2010, the Hearing Officer issued an Order granting the interventions of the Consumer Advocate, the City, and the CRMA, and setting a status conference on October 18, 2010 to address any pending intervention petitions, identify issues, set a procedural schedule, and issue a Protective Order.[12]

On October 14, 2010, a petition to intervene was filed by the Utility Workers Union of America, AFL-CIO and UWUA Local 121 ("UWUA" or the "Union"), and on October 18, 2010, Walden's Ridge Utility District ("Walden's Ridge") and the City of Signal Mountain ("Signal Mountain"), a municipality, also filed a joint petition to intervene in this docket. Pursuant to special contracts with TAWC, Walden's Ridge and Signal Mountain purchase all of their water for distribution to their customers from TAWC.

A status conference was convened on October 18, 2010, at which time the parties submitted an agreed proposed protective order to the Hearing Officer. The Hearing Officer granted the UWUA's petition to intervene, but the joint petition of Walden's Ridge and Signal Mountain was filed too late to be considered during the status conference. Thereafter, motions were filed by the UWUA, the City, and the Consumer Advocate for permission to issue discovery requests exceeding the number set by TRA rule. In an Initial Order issued on November 12, 2010, the Hearing Officer established a preliminary procedural schedule, granted the joint petition of Walden's Ridge and Signal Mountain, and limited the Consumer Advocate

[11] Transcript of Proceedings, pp. 42-43 (September 27, 2010).
[12] *See Order Granting Petitions to Intervene and Requiring the Parties to Submit a Proposed Procedural Schedule and Protective Order* (October 12, 2010).

to eighty initial requests, and the UWUA and the City to forty requests each, the limit set by TRA Rule 1220-1-2-.11(5)(a).[13] On November 15, 2010, the Hearing Officer entered the proposed protective order, which was subsequently amended pursuant to TAWC's unopposed motion.

The CAPD, the City, the CRMA, and the UWUA (collectively, the "Intervenors") filed pre-filed direct testimony on January 5, 2011. The CAPD submitted the testimony of William H. Novak, John Hughes, Dr. Christopher C. Klein, and Terry Buckner. The City filed the testimony of Kimberly H. Dismukes. The CRMA filed the testimony of Michael Gorman, and the UWUA filed the testimony of James Lewis. The CAPD filed a correction to the pre-filed testimony of Dr. Klein on January 24, 2011 and amended testimony from Mr. Buckner on January 31, 2011. On February 8, 2011, the Company filed the pre-filed rebuttal testimony of Dr. Spitznagel, Bernard L. Uffelman, Ms. Miller, Mr. Vander Weide, James I. Warren, Mr. Baryenbruch, Mr. Watson, Mr. Herbert and Mr. Miller. Following additional discovery, the Company filed Revised Exhibits on February 14, 2011. In addition, the Company filed supplemental revised exhibits on February 16, 2011, the revised rebuttal testimony of Mr. Miller on February 17, 2011, and final supplemental revised exhibits on February 22, 2011. The City filed amended testimony of Ms. Dismukes, along with revised schedules KHD-15 and KHD-17, on February 10, 2011. The Consumer Advocate filed the rebuttal testimony of Mr. Buckner on February 24, 2011 and several revisions to the testimony of Mr. Hughes on March 1, 2011.

Various filings were made in this docket in accordance with the procedural schedule, and discovery responses were supplemented and updated by TAWC and the intervening parties throughout the course of the docket. TAWC also responded to data requests from the TRA staff. In addition, on February 14, 2011 and February 16, 2011, TAWC filed revised supplemental

[13] Tenn. Comp. R. & Regs. 1220-1-2-.11(5)(a); *Order Granting Petitions to Intervene, Reflecting Action Taken at Status Conference and Establishing a Procedural Schedule*, p. 9 (November 12, 2010).

accounting exhibits and work papers to replace those that were submitted with earlier pre-filed testimony.

I. DISPUTED PRE-HEARING MATTERS

During the pre-hearing process, the Hearing Officer resolved a variety of disputed matters that emerged between the parties, the most significant of which included the following:

CITY'S MOTIONS TO COMPEL DISCOVERY

On November 18, 2010, the City filed a motion to compel, requesting that the Hearing Officer compel TAWC to respond to certain discovery requests. In this motion, the City asserted that TAWC refused to produce a log identifying the documents and information that TAWC had withheld from discovery based on a claim of privilege or protection, and the City asked that the Hearing Officer compel TAWC to comply with Tenn. R. Civ. P. 26.02(5).[14] The City filed a subsequent motion to compel on December 6, 2010.[15] The second motion, however, involved other discovery objections asserted by the City and did not relate to production of a privilege log.

On December 23, 2010, the Hearing Officer issued an Order finding that Tenn. R. Civ. P. 26.02(5) did not contain a provision that made the production of a "privilege log" mandatory.[16] Therefore, the Hearing Officer did not require the parties to prepare "privilege logs," concluding instead that a party that claims a privilege or protection from discovery should provide specific information about the items it has withheld and set forth its reasons for doing so.[17] Accordingly, the Hearing Officer ordered the parties to identify any information and/or documents withheld from discovery on grounds of privilege or protection, state the privilege or protection claimed,

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[14] *The City of Chattanooga's Motion to Compel Tennessee American Water Company to Respond to Discovery Requests,* pp. 3-4, § B (November 18, 2010).
[15] *The City of Chattanooga's Second Motion to Compel Tennessee American Water Company to Respond to Discovery Requests* (December 6, 2010).
[16] *Order on First Round Discovery Disputes,* pp. 18-19 (December 23, 2010).
[17] *Id.*

and describe the withheld materials with sufficient specificity so as to enable the Authority to evaluate "the applicability of the claimed privilege or protection."[18]

Thereafter, on December 30, 2010, TAWC filed its response, entitled *TAWC Privilege Log Document*. TAWC's privilege log charted ninety-six written communications and materials that TAWC determined to be responsive to discovery requests on which it asserted the applicability of a privilege or protection.[19] All of the communications and materials identified in TAWC's privilege log related in some respect to the management audit that had been ordered by the TRA in Docket No. 08-00039. TAWC acknowledged that it had withheld these communications and materials, which were classified as internal e-mail messages, chains of internal e-mail exchanges, documents, and attachments, on grounds of attorney-client privilege or work product, or both.[20]

On January 7, 2011, the City filed with the Authority a third motion to compel, in which the City asserted that TAWC's privilege log failed to comply with the Hearing Officer's December 23, 2010 Order because the log did not describe the materials withheld in a manner that enabled the parties or the TRA to determine the factual basis of TAWC's claims of attorney-client privilege and/or work product protection.[21] On January 14, 2011, the Company filed its response to the City's third motion to compel. In its response, TAWC contended that it had properly asserted its claims of attorney-client privilege and work product as to each item listed in its privilege log and that it had, in fact, gone beyond the requirements of the Hearing Officer's ruling on discovery by producing a privilege log that identified the sender of the communication

[18] *Id.* at 19.
[19] *TAWC Privilege Log Document* (December 30, 2010).
[20] *Id.*
[21] *The City of Chattanooga's Third Motion to Compel Tennessee American Water Company to Respond to Discovery Requests,* pp. 4-5 (January 7, 2011).

and its recipients, provided the date and general subject matter, and set forth the privilege or protection asserted as its basis for withholding each item.[22]

TAWC asserted that all of the materials not produced consisted of documents or written descriptions of communications that had been exchanged internally between TAWC employees, or between TAWC employees and TAWC's parent company, AWWC, its affiliated service company American Water Works Service Company ("AWWSC"), state affiliate companies, or legal counsel.[23] Further, TAWC asserted that the internal email communications and documents, which all related to some aspect of the management audit, were intended to be confidential and were created in the course of ongoing litigation or in reasonable anticipation of litigation.[24] TAWC further asserted that it had provided the parties with all of the discoverable, non-privileged communications that had been exchanged between TAWC and the auditor, Schumaker & Co.[25]

TAWC stated that the sole purpose of the audit was to confirm or reject the reasonableness of the management fees sought by TAWC in contested litigation, and that any business-related purpose was incidental and ancillary.[26] According to TAWC, each item listed on its privilege log represented internal communication "about the TRA management audit, an audit that has little, if any, commercial or business purpose for the Company outside these contested rate cases."[27] For this reason, TAWC asserted that, under the work product doctrine, all of TAWC's internal correspondence relating to the Schumaker management audit would be protected from discovery.[28] Other documents withheld on grounds of attorney-client privilege,

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[22] *Tennessee American Water Company's Response to the City of Chattanooga's Third Motion to Compel,* pp. 3-4 (January 14, 2011).
[23] *Id.* at 7.
[24] *Id.* at 6.
[25] *Id.* at 4.
[26] *Id.* at 6.
[27] *Id.* at 8.
[28] *Id.* at 6.

according to TAWC, were confidential communications with in-house legal counsel concerning the audit and would also be exempt from disclosure.[29]

In a motion for leave to reply filed on January 18, 2011, the City contended that by merely providing conclusory statements, TAWC had not met its burden, as the party opposing discovery, to demonstrate a factual basis for its nonproduction of the email communications and documents at issue.[30] Further, the City asserted that merely sending copies of documents to in-house counsel does not conclusively establish attorney-client privilege or protection from discovery.[31] Rather, the party opposing discovery must demonstrate that the elements of the privilege or protection are present as to each item withheld.[32] On January 24, 2011, TAWC filed an affidavit by Mr. Miller to provide evidentiary support for its privilege log and to bolster its assertions of the attorney-client privilege and work product protection.[33] During the Status Conference held on January 24, 2011, the parties presented extensive oral argument before the Hearing Officer on the City's third motion to compel.

On February 25, 2011, the Hearing Officer issued an Order setting forth an extensive discussion of the attorney-client privilege, the work product doctrine and the use of privilege logs in asserting those protections in response to discovery requests.[34] The Hearing Officer provided substantive analysis of TAWC's privilege log and concluded that TAWC did not sufficiently describe the nature of the information that it had withheld to enable the Authority to make a determination as to the applicability of the privileges or protections asserted by TAWC.[35]

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[29] *Id.* at 7-8.
[30] *City of Chattanooga's Motion for Leave to Reply in Support of Its Third Motion to Compel,* pp. 2-3 (January 18, 2011).
[31] *Id.* at 3-4.
[32] *Id.*
[33] Michael Miller, Affidavit (January 24, 2011).
[34] *Order Reflecting Hearing Officer's Ruling with Respect to City of Chattanooga's Third Motion to Compel* (February 25, 2011).
[35] *Id.* at 16-27.

Further, the Hearing Officer found that TAWC's descriptions of the materials withheld consisted of a general categorization of communications that were a part of the audit process and did not provide a factual basis from which the Hearing Officer could readily determine the applicability of privilege.[36] Because TAWC had the burden of demonstrating that the communication or document was covered by privilege or otherwise protected, the application of privilege had to be clearly shown.[37] Further, the Hearing Officer concluded that such application of privilege had to be construed narrowly.[38]

Therefore, the Hearing Officer determined that for items as to which the attorney-client privilege was raised, TAWC was required to establish with objective facts or competent evidence that the communication was made in order to seek or give legal advice, and not for a business or other purpose, and was intended to be kept confidential, and the privilege had not been waived. Without such specificity, the Hearing Officer could not conclude, based on the subject matter descriptions that the items for which TAWC asserted attorney-client privilege or work product protection was, in fact, protected.[39] Nevertheless, recognizing the importance of maintaining a valid privilege or protection, the Hearing Officer ordered an *in camera* review of the communications and documentation listed in TAWC's privilege log to determine whether the attorney-client privilege or work product protection should attach to the materials.[40] The decision of the Hearing Officer was announced at a pre-hearing conference held on February 25, 2011. Counsel for TAWC agreed to meet with and provide the materials to the TRA's General Counsel for that purpose on February 27, 2011.

On February 27, 2011 and March 2, 2011, TRA General Counsel, accompanied by TRA Deputy General Counsel, conducted an *in camera* review of the materials referenced in TAWC's

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[36] *Id.*
[37] *Id.*
[38] *Id.*
[39] *Id.* at 27.
[40] *Id.*

privilege log. TRA counsel examined in detail all of the communications and documents noted or otherwise referred to in the privilege log. Mr. Miller, who serves as TAWC's Treasurer/ Comptroller was present with TRA counsel on March 2, 2011 and responded to questions and provided clarification as requested. Upon completion of the *in camera* review, TRA counsel concluded that the communications and documents identified in the privilege log had either been produced to the parties in discovery already or qualified for protection from discovery. The TRA's General Counsel subsequently conveyed those conclusions to counsel for TAWC and the City.

Deposition and Testimony of Patricia Schumaker

On January 12, 2011, TAWC filed a motion stating that as Schumaker & Company had prepared the comprehensive independent management audit ordered by the TRA, it requested that the TRA call Patricia H. Schumaker to present testimony in this case.[41] Specifically, TAWC wanted Ms. Schumaker to address the procedures, methodology and facts that support the conclusions contained in the audit because the intervening parties had indicated that they intended to call those same components of the audit into question.[42]

In addition, on January 18, 2011, the City filed its own motion requesting the setting of a deposition of Ms. Schumaker.[43] Both motions were addressed by the Hearing Officer during a status conference held on January 24, 2011. Subsequently, by letter dated January 28, 2011, the parties agreed on a procedure for taking Ms. Schumaker's deposition.[44] After ascertaining the availability of Ms. Schumaker and the parties, on February 11, 2011, the Hearing Officer issued an Order setting Ms. Schumaker's deposition for February 18, 2011,[45] in the Hearing Room of the TRA with General Counsel presiding over the deposition. The deposition of Ms. Schumaker

[41] *Motion to Call Schumaker & Company to Present Testimony Regarding Its Affiliate Audit Report of Tennessee American Water Company for the Tennessee Regulatory Authority,* p. 1 (January 12, 2011).
[42] *Id.* at 3.
[43] *City of Chattanooga's Motion That Witness Be Ordered to Appear for Deposition,* p.1 (January 18, 2011).
[44] *Letter from Henry Walker to Chairman Mary W. Freeman* (January 28, 2011).
[45] *Order Setting the Deposition of Patricia H. Schumaker,* p. 2 (February 11, 2011).

was taken on February 18, 2011, with the City, the Consumer Advocate and TAWC participating in the questioning.

Following her deposition, the parties agreed that Ms. Schumaker would appear and provide testimony during the Hearing in Chattanooga on Tuesday, March 1, 2011. During the Pre-Hearing Conference held on February 25, 2011, the parties requested clarification as to the manner in which Ms. Schumaker would offer her testimony during the Hearing. Based on the parties' agreement, it was determined that counsel for TAWC would initially question Ms. Schumaker as an independent witness, followed by questioning by counsel for the intervening parties consistent with the order established during the Pre-Hearing Conference.[46]

UWUA'S MOTION TO SUBSTITUTE AFFIANT AND TAWC'S MOTION IN LIMINE

On February 7, 2011, the UWUA filed a motion requesting permission to substitute the sworn statement of Martin R. Blevins for that of Jerry Haddock, which had been attached to Mr. Lewis's pre-filed testimony.[47] Stating that Mr. Haddock's current job made it difficult for him to be available, the UWUA requested permission to present Mr. Blevins for examination during the hearing and include his testimony in the record.[48] According to the UWUA, Mr. Blevins was familiar with TAWC's valve maintenance program and could attest to the accuracy of Mr. Haddock's descriptions.[49] UWUA stated that it had only recently become aware of Mr. Blevins's availability and, thus, had acted in as timely a manner as possible in obtaining his sworn statement.[50]

In a response filed on February 14, 2011, TAWC contended that the UWUA's motion to substitute should be denied as improper and without any basis under the Tennessee Rules of

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[46] *See Order Establishing Procedure for Testimony of Patricia H. Schumaker,* p. 3 (February 28, 2011).
[47] *Motion to Substitute Affiant,* p. 1 (February 7, 2011).
[48] *Id.*
[49] *Id.*
[50] *Id.* at 2.

Civil Procedure, the Tennessee Rules of Evidence, or the TRA's Rules.[51] TAWC asserted that, as the Intervenors' pre-filed testimony was due by January 5, 2011, Mr. Blevins's statement was untimely under the November 12, 2010 procedural schedule.[52] TAWC also noted that, in fact, the UWUA had previously stated that it did not intend to call Mr. Haddock.[53] Nevertheless, less than three weeks before the Hearing, the UWUA had offered Mr. Blevins to provide testimony through the adoption of Mr. Haddock's statement.[54] TAWC further asserted that there was no legal basis for allowing a witness to "adopt" the affidavit of another individual; such adoption would constitute hearsay on three levels.[55] TAWC further noted that Mr. Haddock's written statement was not an affidavit as it was unsworn.[56]

The Hearing Officer denied the UWUA's motion to substitute, finding that Mr. Haddock's statement was not confirmed by oath or affirmation but was merely submitted as a signed statement attached to Mr. Lewis's pre-filed testimony.[57] The Hearing Officer also found that because Mr. Haddock had not been designated as a witness and the UWUA had not pre-filed any testimony from him, Mr. Blevins could not adopt Mr. Haddock's statement and then testify in person.[58] The Hearing Officer further determined that the UWUA's request was both prejudicial and improper.[59]

In conjunction with its response to the UWUA's motion, TAWC filed a motion in limine

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[51] *Tennessee American Water Company's Response in Opposition to the Utility Workers Union of America, AFL-CIO and UWUA Local 121's Motion to Substitute Affiant*, p. 1 (February 14, 2011).
[52] *Id.* The only pre-filed testimony filed by the UWUA was that of Mr. Lewis, which included a statement signed by Mr. Haddock in support of certain portions of Mr. Lewis's testimony. Mr. Haddock did not submit pre-filed testimony, and the UWUA never indicated that Mr. Haddock was intended to be a witness or provide testimony. *Id.* at 2.
[53] *Id.*
[54] *Id.*
[55] *Id.* at 2-3. First, Mr. Lewis was reciting his conversation with Mr. Haddock; second, Mr. Blevins was attesting to Mr. Haddock's statement; and, third, Mr. Haddock's unsworn statement was an out-of-court statement inadmissible as hearsay. *Id.*
[56] *Id.*
[57] *Order Denying the UWUA's Motion to Substitute Affiant and Granting TAWC's Motion in Limine to Strike the Statement of Jerry Haddock, Strike Certain Testimony of James Lewis, and to Exclude the Testimony of Martin Blevins*, pp. 3-4 (February 25, 2011).
[58] *Id.*
[59] *Id.*

on February 14, 2011 asking the Authority to strike both Mr. Haddock's unsworn statement and portions of Mr. Lewis's testimony.[60] TAWC also moved to exclude Mr. Blevins's testimony.[61] Stating that Mr. Lewis's testimony about its valve operations and maintenance was based solely on Mr. Haddock's unsworn statement, TAWC asked that Mr. Haddock's statement be stricken.[62] TAWC asserted that attaching it to Mr. Lewis's pre-filed testimony did not convert Mr. Haddock's statement into pre-filed testimony.[63] TAWC contended that Mr. Lewis did not have personal knowledge of valve operations and maintenance and merely relied on a conversation with Mr. Haddock.[64] TAWC also argued that Mr. Blevins's testimony should be excluded as hearsay and untimely.[65]

On February 25, 2011, the Hearing Officer issued an Order striking, as inadmissible hearsay, the portions of Mr. Lewis's pre-filed testimony that recounted his discussion with Mr. Haddock concerning valve operations and maintenance; the Hearing Officer further ruled that Mr. Lewis would not be permitted to adopt Mr. Haddock's statement or testify at the hearing.[66] Relying on Tenn. R. Evid. Rule 602, the Hearing Officer found that Mr. Lewis could not testify about TAWC's valve maintenance and operation for lack of personal knowledge.[67] The Hearing Officer struck Mr. Haddock's statement and ruled that Mr. Blevins would not be permitted to adopt Mr. Haddock's statement or testify, since the UWUA had not identified or pre-filed testimony from him.[68]

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[60] *Tennessee American Water Company's Motion In Limine to Strike the Statement of Jerry Haddock, Strike Certain Testimony of James Lewis, and to Exclude the Testimony of Marvin Blevins*, p. 1 (February 14, 2011).
[61] *Id.*
[62] *Id.*
[63] *Id.*
[64] *Id.*
[65] *Id.*
[66] *Order Denying the UWUA's Motion to Substitute Affiant and Granting TAWC's Motion in Limine to Strike the Statement of Jerry Haddock, Strike Certain Testimony of James Lewis, and to Exclude the Testimony of Martin Blevins*, pp. 6-7 (February 25, 2011).
[67] *Id.* at 6.
[68] *Id.* at 7.

On February 28, 2011, the UWUA filed a request to appeal the Initial Order.[69] Also that day, the parties presented oral argument on the Union's reconsideration request before the full panel prior to the hearing.[70] The Union explained that Mr. Haddock's statement was an exhibit to Mr. Lewis's testimony, and Mr. Haddock would not be available to attend the hearing.[71] Therefore, the Union asserted, it was necessary to replace Mr. Haddock with Mr. Blevins, who was also a former TAWC employee and had been Mr. Haddock's direct supervisor in valve maintenance.[72] The Union stated that Mr. Blevins would attest to Mr. Haddock's statement and was available to participate in the hearing.[73] The Union acknowledged that Mr. Haddock's statement was not notarized but stated that it included the representation, "I swear and affirm this statement is true to the best of my knowledge," and Mr. Blevins's statement adopting Mr. Haddock's statement was notarized.[74]

In addition, the Union contended that variances in the form of an affidavit are allowed when necessary to prevent injustice and urged the panel to consider the circumstances under which Mr. Haddock's statement was prepared.[75] Because of his new job as a truck driver, Mr. Haddock was not able to get a notary public to witness his statement.[76] The UWUA asserted that Mr. Haddock was merely a retired former TAWC employee and, under the circumstances, his statement should be accepted.[77] In addition, UWUA stated that Mr. Blevins was able to attest to Mr. Haddock's statements on the important issue of valve maintenance at TAWC.[78] The UWUA further stated that Mr. Blevins had been directly involved in the Company's valve maintenance

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[69] *Petition for Appeal of the Hearing Officer's Initial Order Granting the City of Chattanooga's First Motion in Limine* (February 28, 2011).
[70] Transcript of Proceedings, Vol. I A, pp. 49-69 (February 28, 2011).
[71] *Id.* at 50.
[72] *Id.*
[73] *Id.*
[74] *Id.* at 49-50.
[75] *Id.* at 51.
[76] *Id.*
[77] *Id.* at 51-52.
[78] *Id.* at 52.

activities, could speak from personal knowledge, and had been Mr. Haddock's direct supervisor.[79] The UWUA also stated that the substance of the testimony had been made available to the Company in a timely manner.[80]

TAWC responded that it would be highly improper to allow Mr. Blevins to "adopt" the statement of Mr. Haddock because it constituted multiple levels of hearsay.[81] Further, TAWC asserted that Mr. Haddock's unsworn statement did not meet the requirements of Tennessee law and would not be allowed into evidence in court.[82] TAWC reiterated that Mr. Blevins's testimony was untimely filed.[83] TAWC also noted that Mr. Lewis was not an expert on valves and his current job duties were to handle arbitrations, negotiate contracts, and handle grievance procedures.[84] The inclusion of a signed statement of a former TAWC employee was clearly the Union's attempt to use an exception that applies only to expert testimony, but Mr. Lewis was not testifying as an expert.[85] Finally, the Company argued that it was highly prejudicial to bring Mr. Blevins into the proceeding only two and half weeks before the hearing, as it had not had an opportunity to conduct discovery in response to his testimony.[86]

The panel questioned the parties at length about Mr. Haddock's possible unavailability, the basis of Mr. Blevins's personal knowledge, the importance of the issues, and the potential prejudice to TAWC.[87] The panel voted to uphold, but modify, the Hearing Officer's Order.[88] The panel directed the UWUA to produce Mr. Haddock to testify and be cross-examined on the valve issues.[89] In the event Mr. Haddock was not available, the question of whether Mr. Blevins

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[79] *Id.* at 52-53.
[80] *Id.* at 54-55.
[81] *Id.* at 55.
[82] *Id.*
[83] *Id.* at 56.
[84] *Id.* at 57.
[85] *Id.*
[86] *Id.*
[87] *Id.* at 59-68.
[88] *Id.*
[89] *Id.*

would be permitted to testify was left open due to the importance of the valve maintenance issue and its possible impact on the setting of rates.[90]

TAWC'S MOTION TO STRIKE CONSUMER ADVOCATE'S REBUTTAL TESTIMONY

On February 24, 2011, the Consumer Advocate filed rebuttal testimony from Mr. Buckner in response to certain testimony presented during Ms. Schumaker's deposition on February 18, 2011, and also to address the revised tax position of TAWC and an audit report prepared concerning New Jersey American Water Company.[91] In a motion in limine filed on February 25, 2011, TAWC moved to strike Mr. Buckner's rebuttal testimony including the attached audit of New Jersey American Water Company.[92]

The parties presented oral argument on this motion in limine during a Pre-Hearing Conference held on February 25, 2011. TAWC asserted that, contrary to the permissible scope of rebuttal testimony set forth following the deposition of Ms. Schumaker, the rebuttal testimony of Mr. Buckner, filed by the Consumer Advocate, was an improper attempt to put forth testimony concerning unrelated tax issues.[93] TAWC further asked that the audit report of New Jersey American Water Company be stricken as unreliable hearsay because it had not yet been considered, much less approved, by the New Jersey Board of Public Utilities and was not similar to the type of audit ordered by the TRA.[94] In response, the Consumer Advocate asserted that the New Jersey American Water Company audit was not being offered for the truth of the matters asserted therein, but instead was provided as an example for comparison with the audit of TAWC performed by Ms. Schumaker.[95] According to the Consumer Advocate, Mr. Buckner's testimony concerning the tax issues was filed due to the Company's change in position on those

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[90] *Id.*
[91] Terry Buckner, Pre-filed Rebuttal Testimony (February 24, 2011).
[92] *Tennessee American Water Company's Motion in Limine to Strike the Rebuttal Testimony of Terry Buckner and Attachment* (February 25, 2011).
[93] *See Order Granting, in Part, and Denying, in Part, Tennessee American Water Company's Motion in Limine to Strike Testimony of Terry Buckner and Attachment*, p. 1 (February 25, 2011).
[94] *Id.*
[95] *Id.*

issues as set forth in the pre-filed rebuttal testimony of Michael A. Miller filed on February 17, 2011.[96]

Based on the Company's second motion in limine and the arguments presented by the parties, the Hearing Officer determined that the New Jersey American Water Company audit and the rebuttal testimony of Mr. Buckner with respect to that audit should not be considered as evidence in this proceeding or be filed as part of the record.[97] Nevertheless, the Hearing Officer ruled that because the audit was not being offered for the truth of the matters asserted therein, the audit of New Jersey American Water Company could be used during cross-examination of witnesses but not filed as evidence.[98] The Hearing Officer also ruled that the rebuttal testimony of Mr. Buckner with respect to the tax issues should not have been filed with testimony to rebut the deposition testimony of Ms. Schumaker, but would be permitted as testimony offered to rebut TAWC's change in position.[99]

THE CITY'S MOTION TO EXCLUDE TAWC'S REGULATORY EXPENSES ARISING FROM DOCKET NO. 08-00039

On January 28, 2011, the Tennessee Court of Appeals issued its decision in *Tennessee American Water Co. v. Tennessee Regulatory Authority*, Case No. M2009-00553-COA-R12-CV, in which it affirmed in part, and reversed in part, the TRA's Final Order in TAWC's rate case filed in TRA Docket No. 08-00039. In its Opinion, the Court reversed the TRA's decision to limit TAWC to a recovery of one half, or $275,000, of its projected rate case expenses requested in Docket No. 08-00039, and ruled that TAWC should instead recover "the full amount of its proposed rate case expenses."[100] Thereafter, on February 8, 2010, TAWC amended its request for recovery of rate case expenses in this rate case proceeding (Docket No. 10-00189) to include

[96] *Id.* at 2.
[97] *Id.* at 2-3.
[98] *Id.* at 3.
[99] *Id.* at 3.
[100] *Tennessee American Water Co. v. Tenn. Regulatory Auth.*, 2011 WL 334678, at *30 (Tenn. Ct. App. Jan. 28, 2011).

the rate case expenses previously denied in Docket No. 08-00039.[101] In a motion in limine filed on February 24, 2011, the City asserted that the rate case expenses associated with the Company's previous rate case in Docket No. 08-00039 were not properly before the Authority because the Authority's subject matter jurisdiction would not be reinstated until transmission of the mandate by the Court of Appeals, which had not yet been received as of February 8, 2010.[102]

Due to timing, TAWC did not have an opportunity to file a written response, but the Company presented oral argument before the Hearing Officer during the Pre-Hearing Conference held on February 25, 2011. In responding to the City's motion in limine, TAWC stated that the Authority should take judicial notice of the Court of Appeals' January 28, 2011 Opinion so as to include and expedite the Company's recovery of the unrecovered portion of its regulatory expenses incurred in Docket No. 08-00039.[103] TAWC argued that including in this rate case the regulatory expenses related to Docket No. 08-00039 was more efficient for the Company and the Authority, and that it would not be improper for the Authority to consider TAWC's accumulated deferred regulatory expenses with its current projected expenses, as a whole.[104] According to TAWC, the Authority's consideration in this docket of the Company's regulatory expenses, including those not recovered previously as part of Docket No. 08-00039, would not violate the jurisdictional parameters of the TRA.[105]

During the Pre-Hearing Conference held on February 25, 2011, the Hearing Officer informed the parties that the City's motion in limine was well-founded and, therefore, was granted. On February 25, 2011, the Hearing Officer issued an Order granting the City's motion

[101] Michael A. Miller, Pre-Filed Rebuttal Testimony, pp. 75-79 (February 8, 2011).
[102] *City of Chattanooga's First Motion in Limine* (February 24, 2011).
[103] *Order Granting City of Chattanooga's First Motion in Limine*, p. 3 (February 25, 2011).
[104] *Id.*
[105] *Id.*

in limine, which reflected that ruling.[106] Later, TAWC raised the issue of rate case expense in Docket No. 08-00039 before the panel during the Hearing.

Thereafter, on March 16, 2011, the City filed with the Tennessee Supreme Court a request for permission to appeal the decision of the Court of Appeals. In light of this development, the panel remained firm in its decision and did not consider the $275,000 recovery in its initial deliberations. On May 25, 2011, the City's request for permission to appeal was denied by the Supreme Court, and the Court of Appeals issued its mandate to the Authority on June 7, 2011. On August 3, 2011, the Hearing Officer in this docket issued a notice of filing and deliberations, stating that the Authority would consider the method by which to allow TAWC to recover the unrecovered $275,000 rate case expense during the Authority Conference on August 22, 2011.[107] On August 22, 2011, a majority of the panel voted to allow recovery of the regulatory expense through a separate line item charge on customers' bills that will discontinue once the full amount was recovered.[108] A majority of the panel further directed that the amount should be recovered over a six-month period and be collected from all customer classes, resulting in a uniform surcharge of approximately $0.62 monthly.[109] The Company was directed to file tariffs implementing the surcharge, including all supporting calculations, within ten days and to work with TRA Staff on the line item language that would be acceptable to include in customers' bills.[110]

II. THE HEARING AND POST-HEARING FILINGS

On January 31, 2011, the Authority issued a Notice of Hearing reflecting the panel's

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[106] *Id.*
[107] *Notice of Filing and Deliberations*, p. 1 (August 3, 2011).
[108] Transcript of Authority Conference, pp. 79, 82 (August 22, 2011). Director Kyle, who voted against the prevailing motion, made a motion instead to allow TAWC to recover the $275,000 through an increase in fixed monthly service charges and usage rates, as proposed by the Company, and to direct the Company to reduce the rates to current levels when the Company had collected the $275,000 and to file all documentation for the new rates up to $275,000 and work with David Foster and Pat Murphy of the TRA Staff. *Id.* at 79-81. This motion failed for lack of a second.
[109] *Id.* at 79.
[110] *Id.*

decision to hold the hearing in Chattanooga, Tennessee, during the week of February 28, 2011 through March 4, 2011.[111] On February 14, 2011, TAWC published the required notice of the Hearing in the *Chattanooga Times Free Press* and filed proof of publication with the Authority on February 23, 2011. The Hearing was held in Chattanooga, Tennessee, beginning February 28, 2011 through March 4, 2011, and reconvened in Nashville on March 7 and March 8, 2011. Participating in the Hearing were the following parties and their respective counsel:

> **Tennessee American Water Company – R. Dale Grimes, Esq., E. Steele Clayton, IV, Esq., David Killion, Esq., and Chad Jarboe, Esq.**, Bass, Berry & Sims, PLC, 150 Third Avenue South, Suite 2800, Nashville, TN 37201.
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> **Consumer Advocate and Protection Division – Ryan L. McGehee, Esq., Mary L. White, Esq., and Scott Jackson, Esq.**, Office of the Attorney General, 425 5th Ave. N., John Sevier Building, P.O. Box 20207, Nashville, TN 37202.
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> **City of Chattanooga, Tennessee – Frederick L. Hitchcock, Esq. and Willa B. Kalaidjian, Esq.**, Chambliss, Bahner & Stophel, P.C., 1000 Tallan Building, Two Union Square, Chattanooga, TN 37402; and **Michael A. McMahan, Esq.**, Office of the City Attorney, 100 East 11th Street, Suite 200, Chattanooga, TN 37402.
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> **Chattanooga Regional Manufacturers Association – Henry M. Walker, Esq.**, Bradley, Arant, Boult, Cummings, PLC, 1600 Division Street, Suite 700, P.O. Box 340025, Nashville, TN 37203; and **David C. Higney, Esq.**, Grant, Konvalinka & Harrison, P.C., 9th Floor, Republic Centre, 633 Chestnut Street, Chattanooga, TN 37450-0900.
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> **Utility Workers Union of America, AFL-CIO and UWUA Local 121 – Scott H. Strauss, Esq. and Katherine M. Mapes, Esq.**, Spiegel & McDiarmid LLP, 1333 New Hampshire Ave., NW, Washington, D.C. 20036.

During the Hearing, the Company presented the following witnesses: John Watson, Michael A. Miller, Sheila A. Miller, James Vander Weide, Patrick Baryenbruch, Paul R. Herbert, and Dr. Edward Spitznagel. Witnesses for the Consumer Advocate included Terry Buckner, John Hughes, Dr. Christopher C. Klein, and Hal Novak. Kimberly Dismukes testified on behalf of the City. The Union presented James Lewis and Marvin Blevins as witnesses. The CRMA

[111] Upon consideration of the CRMA's request to hold the Hearing in this matter in Chattanooga, Tennessee (Letter, October 20, 2010), which was supported by all intervening parties and the Hamilton County Commission (Resolution No. 1110-13, October 4, 2010) and duly noting the concerns of the Petitioner (Letters, October 22, 2010 and November 12, 2010) *see also*, Transcript of Proceedings (January 24, 2011), during the regularly scheduled Authority Conference on January 24, 2011, the panel voted unanimously to convene the Hearing on the Merits in Chattanooga, Tennessee. *Id.* at 34-43.

presented the testimony of Michael Gorman based on its proposed agreement with the Company. Public Hearings were held at various times during the Hearing to give TAWC customers and members of the public an opportunity to address the panel. Though several hours were set aside specifically for public comment, a limited number of comments were provided.

Additionally, there were three appeals to the full panel of initial orders issued by the Hearing Officer, two filed by TAWC and one by the UWUA. TAWC appealed to the panel the Hearing Officer's granting of the City's February 24, 2011 motion in limine.[112] The panel unanimously affirmed the Hearing Officer's decision and ruled that, upon receipt of the mandate from the Court of Appeals, the TRA would act swiftly and take the necessary action.[113]

Further, TAWC appealed to the panel the Hearing Officer's February 25, 2011 ruling on the City's third motion to compel.[114] This matter was resolved off the record between the first and second days of the Hearing, and the panel did not take it up again during the Hearing.

Finally, the Union appealed the Hearing Officer's February 25, 2011 initial order on its motion to substitute affiant.[115] After hearing arguments of counsel on this issue, the panel voted to uphold the Hearing Officer's ruling, with the understanding that Mr. Blevins could be heard on matters about which he had personal knowledge, and Mr. Haddock would be heard if he became available.[116]

At the conclusion of the Hearing, Director Roberson expressed concern that the Authority should have a complete record on rate case expenses and moved that the Company be required to provide detailed evidence of rate case expenses in a separate hearing that would be held on March 28, 2011. The motion was approved unanimously by the panel. On March 16, 2011, the

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[112] *Petition for Appeal of the Hearing Officer's Initial Order Granting the City of Chattanooga's First Motion in Limine* (February 28, 2011).
[113] Transcript of Proceedings, Vol. I A, pp. 47-49 (February 28, 2011).
[114] *Tennessee American Water Company's Petition for Appeal of the Hearing Officer's Initial Order Granting the City of Chattanooga's Third Motion to Compel* (February 28, 2011).
[115] *Petition for Appeal of the Hearing Officer's Initial Order* (February 28, 2011).
[116] Transcript of Proceedings, Vol. I A, pp. 67-69 (February 28, 2011).

parties filed a joint motion in which the parties expressed their agreement to limit the amount of rate case expenses in this docket to the $645,000, the amount originally filed in the Company's *Petition.*[117] The agreement was reached in order to expedite the completion of the case within the statutory time required under Tenn. Code Ann. § 65-5-103. As part of the parties' agreement, TAWC further agreed to forego implementing its requested rates under bond until April 5, 2011 as provided in Tenn. Code Ann. § 65-5-103(b)(1).

On March 21, 2011, the parties filed post-hearing briefs. On March 22, 2011, the Hearing Officer issued an Order concluding that it was not necessary to proceed to hearing on the issue of rate case expense in light of the filing of the March 16, 2011 joint motion, which acted as a stipulation between the parties with respect to the necessity, reasonableness, and prudency of rate case expenses incurred by TAWC in this docket, and therefore, no additional evidence was necessary on the issue of rate case expense.[118] In addition, the Hearing Officer re-suspended the Company's tariffs through April 4, 2011.[119]

On March 28, 2011, the CRMA and TAWC filed a joint summary detailing the settlement they had announced during the hearing in Chattanooga on February 28, 2011.[120] In the settlement, the CRMA and TAWC agreed that all three classes of customers would receive an equal percentage of any rate increase.[121] TAWC explained that while the larger industrial customers would receive lower rate increases than smaller industrial customers, the result would be larger plant expansion and more economic growth in the Chattanooga area.[122] However, the settlement agreement between CRMA and TAWC affected only the rates within the industrial

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[117] *Joint Motion for Approval of Rate Case Expenses* (March 16, 2011).
[118] *Initial Order of the Hearing Officer Relating to Proof on Rate Case Expenses and the Joint Motion Filed by the Parties*, pp. 5-6 (March 21, 2011).
[119] *Id.* at 6.
[120] *Summary of Settlement between CRMA and TAWC* (March 28, 2011).
[121] *Id.* at 1.
[122] *Id.* at 1-2.

class.[123]

On April 4, 2011, this docket was convened for consideration of the settlement agreement filed by CRMA and TAWC. The panel directed TAWC to file two sets of tariffs; one set was to reflect an across-the-board increase on all customer classes and individual rates, and the other was to spread the revenue increase proportionately across all customer classes, including industrial customers.[124]

On April 7, 2011 the UWUA filed its objection to the tariffs filed by TAWC asserting that neither tariff incorporated reporting conditions with respect to staffing and valve maintenance issues, which had been placed on the Company by the Authority at the April 4, 2011 Authority Conference.[125] On April 14, 2011, TAWC responded in opposition to the Union's objection.[126]

During the regularly scheduled Authority Conference held on April 18, 2011, the panel voted to deny the Union's objections concerning TAWC's failure to incorporate staffing and valve maintenance reporting requirements into its tariffs, on the condition of TAWC's agreement to submit semi-annual reports concerning its staffing levels and valve operation and maintenance programs to the Utilities Division Chief on April 5th and October 5th of each year.[127] In addition, the panel reconsidered the settlement agreement that had been previously filed by CRMA and TAWC.[128] Thereafter, a majority of the panel voted to approve the settlement agreement of the CRMA and TAWC, and tariffs filed on April 6, 2011 reflecting an across-the-board increase.[129]

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[123] *Notice of Filing Amended Tariffs*, p. 2 (April 6, 2011).
[124] Transcript of Proceedings, p. 65 (April 4, 2011).
[125] *Objection to "Notice of Filing Amended Tariffs"* (April 7, 2011).
[126] *Tennessee American Water Company's Response in Opposition to UWUA's Objection to Notice of Filing Amended Tariffs* (April 14, 2011).
[127] Transcript of Proceedings, p. 10 (April 18, 2011).
[128] *Id.* at 11-12.
[129] Director Sara Kyle voted against the settlement agreement and moved to adopt the tariff to reflect an across-the-board increase to all customer classes and individual rates. Her motion failed for lack of a second. *Id.*

III. CRITERIA FOR ESTABLISHING JUST AND REASONABLE RATES

In carrying out its ratemaking function, the Authority is obligated to balance the interests of the utilities subject to its jurisdiction with the interests of Tennessee consumers; it is obligated to fix just and reasonable rates.[130] The Authority must also approve rates that provide regulated utilities the opportunity to earn a just and reasonable return on their investments.[131]

The TRA is not bound to follow rate-making methodology that it has employed in the past.[132] Further, the Uniform Administrative Procedures Act authorizes the TRA to take notice of "generally recognized technical and scientific facts within the agency's specialized knowledge," and in the evaluation of evidence the agency is specifically authorized to utilize its "experience, technical competence, and specialized knowledge."[133] The TRA is not to be "hamstrung by the naked record" and can consider all relevant circumstances shown by the record, all recognized technical and scientific facts pertinent to the issue under consideration and may superimpose upon the entire transaction its own expertise, technical competence and specialized knowledge.[134]

The Authority considers a petition for a rate increase filed pursuant to Tenn. Code Ann. § 65-5-103 (2004) in light of the following criteria:

1. The investment or rate base upon which the utility should be permitted to earn a fair rate of return;

2. The proper level of revenues for the utility;

3. The proper level of expenses for the utility; and

4. The rate of return the utility should earn.

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[130] Tenn. Code Ann. § 65-5-101 (Supp. 2011).
[131] *See Bluefield Water Works and Improvement Company v. Public Service Comm'n of West Virginia*, 262 U.S. 679 (1923).
[132] *Tennessee American Water Co. v. Tenn. Regulatory Auth.*, 2011 WL 334678, at *25 (Tenn. Ct. App. Jan. 28, 2011); *CF Indus. v. Tennessee Pub. Serv. Comm'n*, 599 S.W.2d 536, 542-45 (Tenn. 1980).
[133] Tenn. Code Ann. §4-5-314 (2011).
[134] *Tennessee American*, 2011 WL 334678, at *26.

It is settled law that the TRA has discretion with regard to setting rates and may exercise this discretion in selecting among the test periods proposed or the use of different test periods altogether.[135] The TRA is not limited to adopting a single test period in order to make known and measurable adjustments to produce just and reasonable rates.[136]

The TRA has the discretion to use a historical test period, a forecast period, a combination of these where necessary, or any other accepted method of rate-making necessary to arrive at a fair rate of return.[137] The Tennessee Supreme Court has noted in this regard:

> [T]here is no statutory nor decisional law that specifies any particular approach that must be followed by the Commission. Fundamentally, the establishment of just and reasonable rates is a value judgment to be made by the Commission in the exercise of its sound regulatory judgment and discretion.[138]

There is no single, precise measure of the fair rate of return a utility is allowed an opportunity to earn. Therefore, the TRA must exercise its judgment in making an appropriate determination. The Authority, however, is not without guidance in exercising its judgment:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.[139]

In addition, the United States Supreme Court has determined that regulated firms are

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[135] *Tennessee American*, 2011 WL 334678, at * 20, *citing Powell Tel. Co. v. Tennessee Pub. Serv. Comm'n*, 660 S.W.2d 44, 46 (Tenn. 1983); *Am. Ass'n of Retired Persons v. Tennessee Pub. Serv. Comm'n*, 896 S.W.2d 127, 133 (Tenn. Ct. App. 1994).

[136] *Tennessee American*, 2011 WL 334678 at *3.

[137] *Id.* at *20.

[138] *Powell Tel. Co. v. Tenn. Pub. Serv. Comm'n*, 660 S.W.2d 44, 46 (Tenn. 1983); *citing CF Industries v. Tennessee Pub. Serv. Comm'n.*, 599 S.W.2d 536 (Tenn. 1980).

[139] *Bluefield Water Works & Improvement Company v. Public Service Commission*, 262 U.S. 679, 692-93 (1923); *see also Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 (1989).

entitled to a return that is "just and reasonable."[140] The rate a firm is permitted to charge should enable it "to operate successfully, to maintain its financial integrity, to attract capital, and to compensate investors for the risks assumed."[141]

The general standards to be considered in establishing the fair rate of return for a public utility are financial integrity, capital attraction and setting a return on equity that is commensurate with returns investors could achieve by investing in other enterprises of corresponding risk.[142] The utility's fair rate of return is the minimum return investors expect, or require, in order to make an investment in the utility.[143] The proper level of return on the Company's capital, including equity capital, must be commensurate with returns on investment in other enterprises having corresponding risk.[144]

Applying these criteria, and upon consideration of the entire record, including all exhibits and the testimony of the witnesses, the panel makes the following findings and conclusions.

IV. TEST PERIOD AND ATTRITION PERIOD

Establishing a "test period," or "test year," allows the Authority to measure a utility's financial operations and investments over a specific twelve-month period. The test period is used to develop an "attrition year," which is the forecast period used to set rates. The test period takes into consideration revenues, expenses, and investments.

The Company used a normalized historical test period of the twelve months ended March 31, 2010 to forecast attrition period results.[145] The Company made normalizing adjustments to the test period to forecast the results for the attrition period of the twelve months ended December 31, 2011.[146] The CAPD, however, used the twelve months ended September

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[140] *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 605 (1944).
[141] *Id.*
[142] *Id.* at 603.
[143] *Id.*
[144] *Id.*
[145] Sheila A. Miller, Pre-Filed Direct Testimony, p. 4 (September 23, 2010).
[146] *Id.*

30, 2010 as its test period for residential, commercial and all other revenue categories, with adjustments for known and reasonably anticipated changes through the attrition year ended December 31, 2011.[147]

The panel finds that both the normalized test period for the twelve months ended March 31, 2010, as proposed by TAWC, and the September 30, 2010 normalized test period, as proposed by Consumer Advocate, are acceptable test periods that best fit each of the individual items being forecasted.[148] Both the Company and the Consumer Advocate are in agreement as to the attrition period, and a majority of the panel votes to adopt the twelve months ended December 31, 2011 as the attrition period.[149]

V. CONTESTED ISSUES

The positions of the parties and the determinations of the voting panel are set out below for each of the following contested issues related to the determination of a fair rate of return: Section V(A) – Revenues; Section V(B) – Expenses; Section V(C) – Taxes and Fees; Section V(D) - Net Operating Income; Section V(E) – Rate Base; Section V(F) – Revenue Conversion Factor; Section V(G) – Rate of Return; Section V(H) – Revenue Deficiency; and Section V(I) – Rate Design.

V(A). REVENUE

In order to accurately calculate overall revenues, TAWC's revenues must be calculated for each class of service. This is a two-step process. First, the number of customers must be determined and thereafter, a growth factor is applied to the number of bills for the test period (typically based on historical trend) to arrive at a forecasted number of bills for the attrition period. The forecasted bills are then multiplied by the current rate for each location and class. The next step in the process is to calculate water usage revenue for the attrition period.

[147] John Hughes, Pre-Filed Direct Testimony, pp. 6,8 (January 5, 2011).
[148] Transcript of Proceedings, p. 63 (April 4, 2011).
[149] *Id.* at 63-65.

Generally, usage is forecasted for the attrition period in much the same way as the number of bills. The water usage is then multiplied by the tariffed usage rates to calculate usage revenue. The flat rate revenue amounts and water usage revenue amounts are added together along with any other revenues, such as forfeited discounts, to arrive at the total amount of revenue forecasted for the attrition period for a particular class of service. The goal in forecasting the number of billing determinants is to develop a forecast that reflects what can be reasonably expected to occur in the future, or the attrition period.

TAWC receives revenue from six customer classes: (1) residential; (2) commercial; (3) industrial; (4) other public authority; (5) other water utility; and (6) public and private fire service. TAWC serves the cities of Chattanooga, Lookout Mountain, Lakeview, Suck Creek, and Lone Oak, Tennessee and sells water to Fort Oglethorpe, Catoosa Utility District, Signal Mountain and Walden's Ridge, Tennessee. Other TAWC operating revenues include service fees, late payment penalties, rent sewer revenues, connection fees and miscellaneous fees.

TAWC projected revenues by starting with billing determinants for the test year ended March 31, 2010. Thereafter, five normalizing adjustments were made: "(1) normalized test year adjustments which include annualizing the rate increase for the following: Walden's Ridge effective June 1, 2009, Signal Mountain effective July 1, 2009, Fort Oglethorpe effective November 1, 2009 and a rate decrease for the commercial classification effective September 1, 2009; (2) weather normalization adjustment for the residential and commercial customer classes; (3) eliminating the net change in accrued revenues; (4) adjusting for a duplicate miscellaneous invoice sent March 2010 to one commercial customer; and (5) including revenue for the estimated number of new customers to be added during the attrition year."[150] TAWC estimated the number of new customers based on twenty-three years of historical data. Based on this data, the Company projected an annual growth rate for residential customers of twenty-six additional

[150] Sheila A. Miller, Pre-Filed Direct Testimony, p. 6 (September 23, 2010).

customers monthly.[151] For commercial customers, the Company projected an additional five customers per month. The Company's forecasted total by class was $37,296,457.[152]

The Company's expert, Dr. Edward L. Spitznagel, Jr., provided testimony on weather normalization usage per customer per day for both the residential and commercial customer classes in the attrition year.[153] Dr. Spitznagel stated that temperature and precipitation cause changes in water consumption and more water would be used in hotter and drier periods.[154] Dr. Spitznagel also pointed to the gradual introduction of water saving appliances that reduce water consumption as affecting usage.[155] He rejected temperature as a variable to use in his predictive models and instead, relied on the Palmer Modified Drought Index ("PMDI").[156]

The Company used a bill analysis that reflects the actual billing determinants for the historical test year and is adjusted to normalize any new customers, loss of customers, or changes in usage (for large users) that occurred in the historical test-year, including customer growth through the attrition year, and an adjustment in residential and commercial usage using weather normalized usage per customer per day.[157]

In rebuttal, on the question of weather normalized daily customer usage during the attrition year, Dr. Spitznagel criticized the CRMA's expert for using the previous five-year averages since it would result in an over-statement of future water consumption by failing to take into account declining water consumption trends.[158] Dr. Spitznagel also called into question the CRMA's expert's methodology and usage estimates.[159] Dr. Spitznagel performed various computations to demonstrate that CRMA witness Mr. Gorman's proposal was an inaccurate

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[151] TAWC's Responses to the TRA's Data Requests Dated September 20, 2010, Question 13, TN-TRA-01-Q013-REVENUES, p. 47 (September 24, 2010).
[152] *Petition*, Exhibit No. 4, Schedule 1 (September 23, 2010).
[153] Dr. Edward L. Spitznagel, Jr., Pre-Filed Direct Testimony, p. 5 (September 23, 2010).
[154] *Id.* at 2
[155] *Id.* at 3.
[156] *Id.* at 4.
[157] Sheila A. Miller, Pre-Filed Direct Testimony, pp. 5-6 (September 23, 2010).
[158] Dr. Edward L. Spitznagel, Jr., Pre-Filed Rebuttal Testimony, pp. 1-2 (February 8, 2011).
[159] *Id.* at 1-2.

predictor of future water consumption because it used data from the period 2005 through 2009 and claimed that residential and commercial consumption are declining.[160]

Dr. Spitznagel criticized Mr. Novak for simply averaging the R-squares, which could be misleading and would not produce the appropriate measure of variation explained by his model.[161] Disputing Dr. Klein's contention that he was unfamiliar with and had ignored considerable literature on estimating water demand, Dr. Spitznagel stated that he has reviewed more than one hundred papers on water demand and found that few pertain precisely to weather normalization.[162] Dr. Spitznagel contended that the papers cited by Dr. Klein are not useful for normalizing average monthly water usage.[163]

CAPD expert Mr. Novak stated that he assisted in developing the current Weather Normalization Adjustment ("WNA") rules for gas utilities in Tennessee and had presented testimony on the development of the first ever-approved WNA for a public utility in the state of Virginia.[164] Mr. Novak also stated that he developed the TRA Staff's WNA model and has testified on WNA issues in numerous rate cases.[165] Mr. Novak testified that neither the TRA nor its predecessor, the Tennessee Public Service Commission ("TPSC"), has ever directly addressed or approved a WNA for TAWC and the Company's statements and conclusions on this issue are incorrect.[166] Mr. Novak stated that he adapted the Staff's WNA model for gas utilities to fully examine the impact of weather on the Company's rate case in TPSC Docket No. 89-15388 and used it to consider the impact of heating and cooling degree-days and rainfall on the residential and commercial sales volumes using linear regressions.[167] Mr. Novak concluded the correlation

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[160] *Id.* at 2-4.
[161] *Id.* at 5-6.
[162] *Id.* at 7.
[163] *Id.*
[164] William H. Novak, Pre-Filed Direct Testimony, p. 7 (January 5, 2011).
[165] *Id.*
[166] *Id.* at 8.
[167] *Id.* at 9.

factors he used were too poor to suggest a direct causal relationship between weather and water use; therefore, he disregarded the results.[168]

Mr. Novak stated that in TPSC Docket Nos. 91-05224, 93-02943, and 96-00969, all of which involved TAWC, the Company accepted the WNA model that he had proposed in the 1989 rate case.[169] Mr. Novak stated that to the best of his recollection, allowance for the impact of weather was excluded because there was no demonstrated direct causal relationship between weather and water sales.[170] The issues in those three cases were settled between the parties without any allowance for weather normalization.[171] He noted that in testimony before the Kentucky Public Service Commission the Company stated that it has been allowed to use a WNA in Tennessee since 1989.[172] While it is possible that TAWC has included a WNA in each of its petitions for rate increases since 1991, all of those rate cases except the last two were resolved through "black box" settlements with no specific resolution of any weather normalization issue.[173] Mr. Novak stated that the 2006 and 2008 rate cases, however, were fully litigated, with the Company's proposed WNA adjustments never being explicitly adopted by the TRA.[174]

Dr. Klein did not agree with Dr. Spitznagel's weather normalization study.[175] Dr. Klein contended that there is considerable literature on estimating water demand that Dr. Spitznagel was either unfamiliar with or had ignored.[176] Dr. Klein pointed out that Dr. Spitznagel included only weather as measured by the PMDI, but none of the studies cited in Dr. Spitznagel's

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[168] *Id.*
[169] *Id.* at 10.
[170] *Id.* at 11.
[171] *Id.* at 10.
[172] *Id.*
[173] *Id.* at 10-11.
[174] *Id.*
[175] Dr. Chris Klein, Pre-filed Direct Testimony, p. 19 (January 5, 2011).
[176] *Id.*

testimony made use of the index.[177] Thus, Dr. Spitznagel's results could be biased due to the failure to include all relevant variables.[178] Dr. Klein stated that Dr. Spitznagel used very little data, looking at only ten data points for each month, and that measures of good fit and statistical significance are generally unreliable for such small samples.[179]

The CAPD used the actual billing determinates reported for the twelve months ended September 30, 2010 as a basis to project forecasted attrition period revenues.[180] The CAPD's forecasted revenues listed by class totaled $38,399,479.[181] The CAPD disagreed with two areas of the Company forecasted operating revenue.[182] First, the CAPD argued that the WNA proposed by the Company should be disregarded in calculating operating revenue.[183] The total WNA adjustment calculated by TAWC for the year ended December 31, 2011 was $318,523.[184]

In forecasting residential revenues, the CAPD compiled monthly billing determinants for that class.[185] These billing determinants were then combined with data from previous TAWC rate cases filed in 2004 (Docket No. 04-00288), 2006 (Docket No. 06-00290), and 2008 (Docket No. 08-00039) because, in the CAPD's view, the data provided in those cases furnished an excellent history of billing determinants for use in trend analysis.[186] The CAPD's calculation of residential operating revenue, which excluded the Company's WNA revenue reduction, exceeded the Company's calculation by $867,880.[187]

In projecting commercial revenue, the CAPD established billing determinants by trending the number of meters and water usage history from the twelve month period beginning August

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[177] *Id.* at 20.
[178] *Id.*
[179] *Id.*
[180] John Hughes, Pre-Filed Direct Testimony, pp. 6,8 (January 5, 2011).
[181] *Id.* at 3.
[182] *Id.* at 3-4.
[183] *Id.*
[184] *Id.*
[185] *Id.* at 6-7.
[186] *Id.*
[187] *Id.* at 8.

2003 through the twelve months ended September 2010 for Chattanooga, Lookout Mountain, Lakeview, and Suck Creek.[188] For Lone Oak, the CAPD used billing determinants from the twelve-month period beginning August 2006 through September 2010.[189] The CAPD's calculation for commercial operating revenue, which excluded the Company's proposed WNA, exceeded the Company's calculation by $147,361.[190]

In projecting industrial revenues, the CAPD established billing determinants by trending the number of meters and water usage history from January 2004 through the twelve months ended September 30, 2010.[191] The CAPD's calculation of industrial operating revenue exceeded that of the Company by $118,733.[192] The CAPD forecasted industrial revenues of $3,520,697 for the attrition period at current rates.[193]

In forecasting Other Public Authority Revenues, the CAPD applied the current rates to its test year billing determinates to arrive at its forecasted attrition period amount.[194] The CAPD contended that the volumetric billing determinants for other public authority revenues in the Chattanooga area have declined from a total of 1,216,889 cubic feet at the beginning of 2004 to a total of 1,025,432 cubic feet in 2009.[195] By using trend analysis on the historical billing determinants, the CAPD detected a decline in volumes and a resulting decline in other public authority revenues.[196] The CAPD forecasted Other Public Authority Revenues of $2,549,888 for the attrition period at current rates.[197]

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[188] *Id.*
[189] *Id.*
[190] *Id.* at 8-9.
[191] *Id.* at 4
[192] *Id.* at 10.
[193] *Id.* at 9.
[194] *Id.* at 10-11.
[195] *Id.*
[196] *Id.*
[197] *Id.*

The CAPD predicted a decline in Other Water Utility Revenue[198] to $1,293,805 during the attrition year ended December 31, 2011,[199] while TAWC estimated that this revenue would remain constant during the attrition period at the test period amount of $1,308,493, which was calculated for the twelve months ended March 31, 2010.[200] The CAPD used the more recent test year data for the year ended September 30, 2010.[201]

The CAPD noted a sharp decline in volumetric usage by Catoosa County during the test year ended September 30, 2010.[202] Based upon this decline, the CAPD forecasted Other Water Utility Revenue would decline by at least $14,688 during the attrition year, noting that the Catoosa Utility District Authority stopped purchasing water from TAWC in 2008.[203]

TAWC calculated Private Fire Service Operating Revenues of $1,735,066 for the attrition period while the CAPD projected $1,719,717.[204] Consistent with the methodology used for other classes of service, the CAPD used historical billing determinants.[205] The CAPD used the trend analysis technique for each pipe size to determine whether any attrition year estimates should be changed.[206] As a result, the CAPD determined that, although the total billing determinants are the same as those in TAWC's forecast, different pipe sizes produced different forecasted revenues.[207] Therefore, the CAPD's trend analysis of Private Fire Service Operating Revenues was $14,688 lower than the amount calculated by TAWC.[208] However, no testimony was offered on Public Fire Service Revenues or Other Operating Revenues. For these categories, the Company projected $1,517,135, and the CAPD projected $1,522,545, for the attrition period of

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[198] The class "Other Water Utility Operating Revenues" included the utility districts of Fort Oglethorpe, Catoosa, Signal Mountain, and Walden's Ridge.
[199] John Hughes, Pre-Filed Direct Testimony, pp. 6,8 (January 5, 2011).
[200] *Id.* at 11-12.
[201] *Id.*
[202] *Id.*
[203] *Id.*
[204] *Id.* at 12-13.
[205] *Id.*
[206] *Id.*
[207] *Id.*
[208] *Id.* at 12-13.

the twelve months ended December 31, 2011.[209] The CAPD amount is greater by an immaterial amount of $5,410.

Mr. Gorman, testifying for the CRMA, attested that Dr. Spitznagel's estimates of 135.93 gallons per customer per day for residential usage and 989.64 gallons per customer per day for commercial usage were simply too low.[210] In fact, the Company's own actual data indicated that Dr. Spitznagel had underestimated daily volume.[211] The CRMA contended that a normal residential consumption estimate of 144.2 gallons per customer per day more reasonably projected actual usage for a residential customer based on historical usage patterns yet still reflected continued water conservation gains.[212] To project the residential usage for Lookout Mountain and Lakeview, the CRMA calculated the percentage change between Mr. Gorman's residential usage estimate and Dr. Spitznagel's for the Chattanooga district and applied that percentage change to volumes that Dr. Spitznagel estimated for Lookout Mountain and Lakeview.[213] Mr. Gorman stated that TAWC's projection of 989.64 gallons per customer per day was not reasonable when compared to the Company's historical data.[214] CRMA recommended that attrition period commercial usage be based on the five-year average of 1,033.6 gallons per day per commercial customer because it was more reasonable and consistent with actual sales volume of commercial customers over the last ten years than the daily volume estimate of 989.64 gallons used by Dr. Spitznagel.[215] Additionally, over the last sixteen years, with the exception of 2009, the actual commercial usage substantially exceeded the estimate proposed by Dr. Spitznagel.[216] Additionally, CRMA pointed out that TAWC's expert used the

[209] John Hughes, Pre-Filed Direct Testimony, Workpaper R-Revenue Comparative Summary (January 5, 2011).
[210] Michael Gorman, Pre-Filed Direct Testimony, pp. 7-8 (January 5, 2011).
[211] *Id.*
[212] *Id.* at 9.
[213] *Id.*
[214] *Id.*
[215] *Id.*
[216] *Id.* at 9-10.

same database and analyzed data for the months of May to September 2009, which was the wettest year since 1895.[217]

TAWC claimed that it did not meet the TRA's revenue forecast adopted in the last rate case, Docket No. 08-00039, and that its revenues have actually decreased by $3.293 million.[218] TAWC claimed that this reduction in revenue accounts for 33.3% of the overall requested rate increase.[219] Nevertheless, in Docket No. 08-00039, the Company had forecasted revenues of $37,142,460 for the attrition period ended August 31, 2009.[220] The CAPD forecasted revenues of $39,492,768. The TRA adopted a revenue forecast of $38,934,309. A comparison of the actual results from TAWC's 3.06 report for the year ended August 31, 2009 (the attrition period used in Docket No. 08-00039) with the revenue figures forecasted by the parties and the TRA showed that the forecast prepared by the TRA was the most accurate. After performing several trend calculations on this historical data and an analysis of the past five years of residential and commercial customer accounts, the Authority accepts as reasonable four of TAWC's normalizing adjustments but excluded weather normalization, as further discussed below.

The Authority rejects the CAPD's projection of meters for the attrition period. During cross-examination, it was unclear which specific information the CAPD relied upon to make its projections, although there was some discussion of data from the 3.06 Monthly Reports. Further, during cross-examination by the Company, the CAPD's witness admitted to having made numerous errors[221] and inappropriate assumptions, and that recognition of these errors had prompted the CAPD to file amended testimony on February 25, 2011, March 1, 2011 and March 8, 2011. The CAPD's projections were found to contain numerous errors and could not be relied

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[217] *Id.* at 10.
[218] Michael A. Miller, Pre-Filed Direct Testimony, p. 6 (September 23, 2010).
[219] *Id.*
[220] *In re: Petition of Tennessee American Water Company to Change and Increase Certain Rates and Charges so as to Permit It to Earn a Fair and Adequate Rate of Return on Its Property Used and Useful in Furnishing Water Service to Its Customers,* Docket No. 08-00039, *Final Order*, p. 9 (January 13, 2009).
[221] Transcript of Proceedings, Vol. IV B, pp. 133-134 (March 3, 2011).

upon with any degree of certainty. Therefore, the Authroity declines to adopt the CAPD's revenue forecast.

The Company's forecast for residential and commercial usage relied on Dr. Spitznagel's WNA model. In the previous rate case for TAWC, Docket No. 08-00039, the Authority made it clear that it had not previously adopted the Company's WNA mechanism.[222] The panel again rejects Dr. Spitznagel's WNA model as it was applied to the residential and commercial classes because the monthly regressions employed in the model have too few observations to be statistically reliable.

The CRMA's witness, Mr. Gorman, testified that the Company underestimated the level of revenues that it would earn at its current rates by overestimating the effect of a reduction in sales due to conservation.[223] He further stated that sales projections would be $1,217,115 more for the attrition period at current rates than forecasted by the Company.[224] However, the CMRA presented little evidence in the form of supporting schedules or workpapers to demonstrate or justify this assertion. For this reason, the Authority has been unable to verify Mr. Gorman's assertions and does not accept the forecast of revenues presented by CRMA.

The TRA determines that the most reasonable historical data upon which to base usage forecasts is contained in the Company's Rebuttal Exhibit MAM-10, Page 5. The moderate decline in usage per customer from 2005 through 2009 was demonstrated by data the Company provided; however, the TRA further notes that this decline has started to level off. This conclusion is based on what the TRA deems to be the most reliable data in the record for determining the future average residential and commercial usage per customer. The TRA's analysis is based on its calculations applying several methodologies used to examine probable future usage per customer, as well as an examination of the historical volumetric usage provided

[222] *Final Order*, Docket No. 08-00039, p. 11 (January 13, 2009).
[223] Michael Gorman, Pre-Filed Direct Testimony, p. 7 (January 5, 2011).
[224] *Id.*

by TAWC in its Rebuttal Exhibit MAM-10. This data clearly demonstrates only a moderate decline in customer usage in recent years. While, as TAWC points out, the data may show usage declining substantially over the entire period 1986 through 2010, usage for residential customers has declined by only one-half gallon per day for the more recent period 2004 through September 2009.

The Company's test period usage was determined from the twelve months ended March 31, 2010 based on a review and analysis of five-year customer counts. The residential and commercial usage, as normalized and adjusted for the attrition period, represented reasonable usage for the test period. Again, the TRA declines to adopt weather normalized adjustments to revenue in forecasting usage.

TAWC and the CAPD both projected a small increase in the Industrial, Other Public Authority, Other Water Utilities, Public/Private Fire Service and Other Operating Revenues classifications from the test period to the attrition period. Little or no testimony was provided by either party on these revenues; however, the projected increases were immaterial. Further, the CAPD's revenue projections have been found to be unreliable in this rate case, having been revised by the CAPD's witness three times during the course of the docket. Therefore, the TRA adopts the projection of TAWC for these revenue classes.

Based on the foregoing, the TRA adopts an estimate of $37,614,978 for total operating revenues for the attrition period consisting of the following: (1) residential revenue of $15,555,318; (2) commercial revenue of $11,540,748; (3) industrial revenue of $3,401,964; (4) other public authority revenue of $2,556,253; (5) other water utility revenue of $1,308,493; (6) private fire service revenue of $1,735,066; (7) public fire service revenue of $0; and (8) other operating revenue of $1,517,135.

V(A)1. AMERICAN WATER RESOURCES ("AWR") WATER AND SEWER PROTECTION PROGRAMS

During the course of the proceedings, the City raised certain issues concerning the Company's relationship, subsidization, and transfer of utility assets and benefits without compensation to its non-regulated affiliate company American Water Resources ("AWR").[225] AWR provides homeowner protection plans to TAWC customers and other AWWC utility customers.[226] These specialized protection programs include water line protection,[227] sewer line protection,[228] and in-home plumbing emergency protection services, which cover certain repairs to the water and/or sewer lines running from a home to the street and for plumbing repairs that occur within the home (lateral water and wastewater lines/facilities owned by the customer, not TAWC), and are designed to insulate homeowners from the unexpectedly high costs that can be associated with water or sewer line failures and in-home plumbing repairs.[229]

Under the *Agreement for Support Services between American Water Resources, Inc. and Tennessee American Water Company ("Service Agreement")* executed on May 1, 2004, TAWC bills to and collects from its mutual customers AWR protection plan charges, distributes AWR promotional marketing materials and customer surveys, and notifies AWR of claims and/or initiates repair services,[230] as follows:

> Billing and Collection. AWR shall provide [TAWC] with a list of enrolled customers in its Programs who have chosen to have charges from AWR included on their bill from [TAWC], and shall keep such list up to date. [TAWC] shall

[225] Like TAWC, AWR is a wholly-owned subsidiary of AWWC.
[226] Kimberly H. Dismukes, Pre-filed Direct Testimony, pp. 10-11 (January 5, 2011); *see also* Michael A. Miller, Pre-filed Direct Testimony, Exhibit MAM-8, p. 26 of 143 (February 17, 2011).
[227] The Water Line Protection Program offered to TAWC customers, subject to its terms and conditions, provides a service to repair customer-owned water lines that leak or break due to normal wear and tear. TAWC's Responses to The TRA's Fourth Set of Data Requests, Question 152, TN-TRA-04-Q152-ATTACHMENT, p. 23 of 24 (*Service Agreement,* Appendix A) (February 18, 2011).
[228] The Sewer Line Protection Program offered to TAWC customers, subject to its terms and conditions, provides a service to clear or repair blocked customer-owned sewer lines that become clogged or blocked due to normal wear and usage. *Id.*
[229] Kimberly H. Dismukes, Pre-filed Direct Testimony, pp. 10-11 (January 5, 2011); *see also* Michael A. Miller, Pre-filed Direct Testimony, Exhibit MAM-8, p. 26 of 143 (February 17, 2011).
[230] TAWC's Responses to The TRA's Fourth Set of Data Requests, Question 152, TN-TRA-04-Q152-ATTACHMENT, pp. 11-13 & 24 of 24 (February 18, 2011) *(Service Agreement* § 6, pp. 8-10 & Exhibit 1).

> include such charges on the customer's bill and collect such charges from the customer until such time as the customer or AWR notifies [TAWC] that the customer is no longer receiving services from AWR or has elected a different payment option. [TAWC] shall forward collected payments from enrolled customers to AWR within fifteen days following the end of each calendar month for amounts collected during such month. . . . AWR shall be responsible for all collection efforts for non-payment by [TAWC] customers for AWR Programs.[231]

In performing its duty to provide billing and collections services, TAWC includes AWR protection plan charges on its regular bill to the customer, collects payments for such charges, along with its own charges for service, and forwards the payments to AWR.[232] Payments are applied first to utility services, and any remainder is thereafter credited to amounts owed to AWR.[233] Utility service will not be interrupted, stopped, or refused, as a result of non-payment of amounts owed to AWR, and AWR is responsible for all collection efforts necessary due to non-payment by TAWC customers for AWR programs.[234]

In addition, AWR is responsible for the administrative activities of the programs,[235] but TAWC agreed to manage and direct the distribution of materials related to the protection plan programs for its customers:

> Distribution of Promotional Materials. Upon request of AWR, [TAWC] shall manage and direct the distribution of informational and promotional materials regarding the Program to its customers. Such materials shall be developed by AWR and provided to [TAWC] in sufficient quantities and in a timely manner so as not to impede any planned distribution efforts by [TAWC]. The materials shall be distributed as a part of [TAWC]'s normal billing process, unless arrangements are made, at least sixty (60) days in advance, for a special mailing. The materials provided by AWR must be satisfactory in form and content to [TAWC], and nothing in this Agreement shall require [TAWC] to distribute any materials that are not satisfactory to [TAWC]. [TAWC] shall make all reasonable efforts to promptly notify AWR when additional quantities of promotional materials are

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[231] *Id.* at 12-13 of 24 (*Service Agreement,* § 6.1.3, pp. 9-10 & Exhibit 1).
[232] *Id.*
[233] *Id.*
[234] *Id.*
[235] Under § 10.4 of the *Service Agreement,* administration of the AWR protection plan programs include activities such as enrollment, billings, accounting, marketing, financial analysis and reporting. *See,* TAWC's Responses to The TRA's Fourth Set of Data Requests, TN-TRA-04-Q152-ATTACHMENT, p. 17 of 24 (February 18, 2011) (*Service Agreement* § 10.4, p. 14).

> needed. [TAWC] shall have the sole discretion to determine the customers who will receive the informational and promotional materials for the Program.[236]

All promotional and informational materials will be developed, produced, printed and supplied to TAWC, by AWR.[237] Further, AWR provides TAWC with the opportunity to review and approve of all materials in advance of distribution to customers.[238] All materials must be satisfactory to TAWC in form and content and TAWC is not compelled to distribute any materials that it does not determine to be satisfactory. TAWC retains control over the form and content of the AWR materials it distributes, and has discretion to determine which customers will receive these materials. In addition, TAWC reviews and has input as to AWR customer surveys prior to distributing such surveys to its customers.[239]

Finally, under the *Service Agreement,* TAWC has also agreed to provide AWR notification of possible claims:

> Notification of Claim. Should a [TAWC] associate, as a part of his/her normal duties, determine that a [TAWC] customer has a covered occurrence with the Customer's water or sewer service line, the [TAWC] associate shall notify AWR by calling a toll-free telephone number to be supplied by AWR. AWR shall then engage a qualified contractor to provide the covered services to the customer. AWR shall timely provide that necessary information to cause [TAWC]'s customer records to reflect when coverage is available.[240]

Thus, TAWC employees who determine, as part of their duties, that a customer has a covered water or sewer line occurrence are required to notify AWR, who then engages a qualified contractor to provide service in accordance with the protection plan.[241]

In its fee provision, the *Service Agreement* distinguishes the fee paid for billing and collection services from other services:

> 4.1 Fee. The fee paid to Utility by AWR for Services rendered pursuant to this Agreement shall be equal to one hundred and fifteen (115%) percent of the Fully

[236] *Id.* at 11-12 of 24 (*Service Agreement,* § 6.1.1, pp. 8-9).
[237] *Id.* at 16 of 24 (*Service Agreement,* § 10.1, p. 13).
[238] *Id.*
[239] *Id.* at 24 of 24 (*Service Agreement,* § 6.1.4, p. 10, Exhibit 1(3)).
[240] *Id.* at 12 of 24 (*Service Agreement,* § 6.1.2, p. 9).
[241] *Id.*

> Distributed Costs incurred by Utility in providing the Services *except* for billing and collection services. The Fee for billing and collection services rendered by Utility as set forth in Paragraph 6.1.3 below shall be at a rate of $.405 per customer per billing period and apply in the aggregate to customers participating in one or more of AWR's Programs. The $.405 rate may be adjusted from time to time as determined by the agency having regulatory authority over Utility to be consistent with any other such billing and collection service rates charged by Utility, under tariff, to others.[242]

As noted, TAWC receives 40.5¢ per customer per billing period for the billing and collection services it renders on behalf of AWR. The *Service Agreement* allows for adjustment of this fee by the TRA in order maintain consistency with any other third-party billing and collection fee arrangements extended to others under the Company's tariff. Other, non-billing and collection, services performed by TAWC, as described in the *Service Agreement,* are to be paid at 115% of the Fully Distributed Costs.[243] The *Service Agreement* defines "Fully Distributed Costs" as follows:

> "Fully Distributed Costs" means costs determined in a manner that complies with the standards and procedures for the apportionment of special, joint, and common costs between the [TAWC] and any non-regulated entity in accordance with applicable regulations of the State commission or board having jurisdiction over the operations of [TAWC], except taxes as discussed in Section 5. A fully distributed costing methodology apportions the total costs of a group of services of products, including the authorized rate of return, among the individual services or products in that group.[244]

Thus, TAWC agreed, in summary, to provide billing and collection "at a rate of $.405 per customer per billing period" **and** to provide services other than billing and collection for "one hundred and fifteen (115%) percent of the Fully Distributed Costs incurred" by it.

Through the testimony of its expert witness, Ms. Kimberly H. Dismukes, the City asserted that AWR receives significant tangible and intangible benefits as a result of its affiliate relationship and association with TAWC and made specific recommendations:

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[242] *Id.* at 10 of 24 (*Service Agreement,* § 4.1, p. 7).
[243] For ratemaking purposes, the costs incurred and revenue received by TAWC as a result of providing service(s) are proper considerations for the TRA in setting just and reasonable rates.
[244] *Id.* at 8 of 24 (*Service Agreement,* § 1, p. 5).

> AWR receives significant benefits as a result of its relationship with TAWC. I recommend that the TRA increase test year revenue by $1,071,281 for representing the revenue earned by AWR from the Protection Programs provided to TAWC customers. I also recommend that the TRA order a thorough examination of this affiliate relationship. Two areas need to be examined. First, procedures should be developed to ensure that costs are properly allocated to AWR to ensure that ratepayers do not subsidize this nonregulated affiliate. Second, the TRA should attribute revenue (through a royalty fee or other mechanism) to TAWC to ensure that ratepayers receive compensation for intangible and tangible benefits bestowed to the nonregulated Protection Programs offered to TAWC customers.[245]

As described in the *Service Agreement,* TAWC is to receive fee compensation for its billing and collection services[246] and payment of 115% of fully distributed costs for other services. Nevertheless, the City asserted that TAWC provides certain services and intangible assets that benefit AWR, for which it is not compensated.[247] These additional services include the use of TAWC's name and president's signature, logo, reputation, goodwill, corporate image, personnel, and customer names and addresses.[248] Ms. Dismukes highlighted TAWC's efforts to promote AWR's services:

> As shown on pages 6, 10, and 13 of Schedule KHD-3, the letters sent to potential customers offering these protection programs were sent on TAWC's letterhead. Moreover, the letters were signed by the President of Tennessee American Water Company. In addition, the letters make strong statements about the potential financial consequences associated with a line break without the program.[249]

The City contended that the transfer of intangible assets and provision of services to AWR, without compensation, demonstrates that "[c]learly there is no arms-length relationship between TAWC and AWR's sale of these Protection Programs."[250] Ms. Dismukes stated:

> There are substantial benefits to AWR for its affiliation with TAWC. These benefits include the use of TAWC's name and president's signature, logo, reputation, goodwill, and corporate image; being associated with a large, financially strong, well-entrenched water company; use of TAWC's personnel;

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[245] Kimberly H. Dismukes, Pre-Filed Direct Testimony, p. 3 (January 5, 2011).
[246] The City noted that TAWC charged AWR $52,617 in 2007, $43,200 in 2008, $39,365 in 2009, and $40,900 for the twelve months ended September 30, 2010, for its provision of third-party billing services to AWR. *Id.* at 10.
[247] *Id.* at 14-17.
[248] *Id.* at 15.
[249] *Id.* at 14.
[250] *Id.* at 15.

> and use of TAWC's customer names and addresses. All of these benefits were developed as a result of the regulated operations of TAWC. However, AWR obtains these significant benefits because of its association with the regulated utility operations at no cost.[251]

Because of its unique association and direct affiliate relationship, AWR obtains free of charge the benefits of assets generated or developed through TAWC's regulated utility operations.[252] Further, TAWC's intangible assets, which are of significant value in the promotion and sale of AWR homeowner protection plans to TAWC customers, are not compensated under the *Service Agreement.* To compensate ratepayers, Ms. Dismukes recommended that TAWC's new rates reflect this relationship with AWR:

> Because of this, I recommend that the TRA increase test year revenue to include the revenue earned by AWR for the provision of these services that is applicable to TAWC. To estimate this amount, I distributed the AWR Home Services revenue to TAWC based upon its proportion of customers to the total number of regulated customers. My recommendation indicates that test year revenue should be increased by $1,071,281, as depicted on Exhibit KHD-4.
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> * * *
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> The TRA should require payment by AWR to TAWC of a royalty fee on the revenue of AWR attributable to tangible and intangible benefits bestowed by TAWC.[253]

Ms. Dismukes recommended that the Authority increase TAWC's test year revenue to include revenue earned by AWR, based upon the proportion of TAWC customers to AWR's total customer base.[254] The City asserted that AWR has 11,129 water line protection contracts, 6,410 sewer line protection contracts and 2,490 home plumbing contracts in Tennessee,[255] and that these programs were marketed through materials printed using TAWC's name and logo, and signed by the President of TAWC.[256] Ms. Dismukes distributed AWR Home Services revenue

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[251] *Id.*
[252] *Id.*
[253] *Id.* at 16.
[254] *Id.* at 16.
[255] *Id.* at 11; *see also* TAWC's First Supplemental Responses To The First Discovery Request And First Responses to the Supplemental Discovery Request Of The CAPD, TN-CAPD-01-Q77 and Q78 (December 2, 2010).
[256] *Id.* at 14 (Schedule KHD-3).

($47,532,000)[257] to TAWC using the ratio (.0225381) of TAWC Customers (74,774) to the total number of AWWC regulated customers (3,317,672).[258] As a result of this calculation, the City asserted that TAWC's test year revenue should be increased by $1,071,281 to account for revenue earned by AWR from its lucrative marketing arrangement with TAWC.[259] During cross-examination, Ms. Dismukes conceded that it would be appropriate to impute the earnings of AWR's Tennessee-specific operations to the revenues of TAWC to compensate the ratepayers.[260]

The City also asserted that the Authority should require AWR to pay a royalty fee to TAWC on the AWR revenue attributable to its use of TAWC's tangible and intangible assets.[261] Ms. Dismukes pointed out that payment of a royalty fee was consistent with the position taken by TAWC witness, Bernard L. Uffelman, in a book on cost allocation, in which Mr. Uffelman discusses the regulatory practice of requiring a non-regulated affiliate to pay a royalty or referral fee to its regulated utility affiliate for use of the utility's brand name and logo.[262] Finally, Ms. Dismukes recommended that the Authority order a thorough investigation of AWR operations and develop procedures to ensure that TAWC ratepayers do not subsidize AWR, an unregulated affiliate.[263]

The CAPD concurred with the City's assertion that additional revenue should be attributed to TAWC for certain services it performs on behalf of its affiliate, AWR.[264] Specifically, the CAPD agreed that AWR receives considerable benefits as a result of its

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[257] As noted in footnote 20 in her pre-filed testimony, Ms. Dismukes obtained AWR Home Service revenue for 2008 from TAWC's response to Schumaker IR 02-39, Attachment 1. *See* Kimberly H. Dismukes, Pre-Filed Direct Testimony, Schedule KHD-4 (January 5, 2011).
[258] *Id.* at 16 (Schedule KHD-4).
[259] *Id.* at 3 (Schedules KHD-2, 3 and 4).
[260] Transcript of Proceedings, Vol. II C, p. 292 (March 1, 2011).
[261] *Id.* at 232, 241-43; *see also* Kimberly H. Dismukes, Pre-Filed Direct Testimony, pp.16-17 (January 5, 2011).
[262] Transcript of Proceedings, Vol. II C, pp. 232, 241-43 (March 1, 2011); *see also* Transcript of Proceedings, Vol. IV B, pp. 81-83 and Hearing Exhibit 53, p. 19 (March 3, 2011).
[263] Kimberly H. Dismukes, Pre-Filed Direct Testimony, p. 16 (January 5, 2011).
[264] *Consumer Advocate and Protection Division's Post-Hearing Brief,* pp. 15-16 (March 21, 2011).

affiliation with TAWC and the use of intangible assets, including TAWC's logo, in the marketing and sale of its products to TAWC customers.[265] Therefore, the CAPD joined with the City in urging the Authority to review the affiliate relationship between TAWC and AWR and consider imputing a portion of AWR's revenues to TAWC.[266]

In response to the City's and CAPD's contentions, the Company, through its witnesses, Mr. Michael A. Miller and Mr. John Watson, asserted that its only participation in the water line/service line protection programs was to provide third-party billing and collection services for AWR at the tariff rate approved by the TRA for such services, which is also the same rate charged to the City of Chattanooga Sanitary Board.[267] Mr. Miller asserted that as TAWC already bills its customers for water service, aside from incremental printing costs, TAWC incurs little, if any, additional cost in providing billing services to AWR:

> The Agreement indicates that TAWC will also bill AWR for any costs not covered by the billing fee at 115% of cost (Article 3.3.2 of the Affiliated Agreement). The Agreement also indicates that TAWC will distribute, upon the request of AWR, informational and promotional materials regarding the AWR programs to its customers though inserts in its billing envelopes, which is the same service TAWC would provide to its contract sewer billing customers upon request.
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> * * *
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> Other than incremental cost to print additional information on the bill and collect the fees there is little, if any, additional costs incurred by TAWC.[268]

Mr. Miller acknowledged that the Company is not compensated for AWR's use of the signature of TAWC's President used on its marketing materials, and asserted that, under the *Service Agreement,* TAWC is entitled to compensation only when it incurs an additional cost,

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[265] *Id.*
[266] *Id.*
[267] Michael A. Miller, Revised Rebuttal Testimony Amendment, p. 95 (February 17, 2011); Transcript of Proceedings, Vol. VI A, p. 52 (March 7, 2011); *see also* TAWC's First Supplemental Responses to City of Chattanooga's First Discovery Request, TN-COC-01-Q39 and TAWC's First Supplemental Responses To The First Discovery Request And First Responses to the Supplemental Discovery Request Of The CAPD, TN-CAPD-01-Q77 and Q78 (December 2, 2010).
[268] Michael A. Miller, Pre-Filed Rebuttal Testimony, p. 96 (February 8, 2011).

and no such cost is incurred.[269] Mr. Watson contended that his endorsement and approval, as TAWC President, has little value or benefit to AWR in the marketing and sale of the protection plans to TAWC customers.[270] Rather, he asserted that the real benefits accrue to the customers in the important service they receive when, through the AWR marketing materials, they become educated of their responsibilities for certain water service/sewer lines and aware of the significant costs involved in maintaining and repairing those lines.[271]

TAWC asserted that it provides no services to AWR that are not covered by the contract billing fee and that such fees "more than adequately compensate" TAWC for the services it provides to AWR.[272] Nevertheless, Mr. Miller's contentions with Ms. Dismukes's recommendations were founded primarily on the claim that TAWC incurs no additional costs in providing services to AWR over or above what TAWC incurs for the regulated services TAWC is already providing to its customers:

> When any customer calls with a concern about a leak, TAWC employees respond initially. If the leak is identified on the customer's service line, they are so advised. . . . Because the Company's personnel always respond to a customer's service issue regarding a high bill or leak, TAWC does not incur any additional costs when it instructs the customer that the leak appears to be on the customer owned line and they need to call AWR if they have the service line protection with AWR.
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> * * *
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> TAWC has borne no cost for producing or sending that information to its customers.
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> The regulatory process is a cost-based process. While Ms. Dismukes perceives value for these attributes, there is no rate base value or expense recognition allowed by the TRA for them. Thus, TAWC recovers nothing from its regulated customers for these attributes or intangible assets. Therefore, there is no value for

[269] *Id.* at 99 (February 18, 2011).
[270] Transcript of Proceedings, Vol. III A, pp. 83-84 (March 2, 2011).
[271] Michael A. Miller, Revised Pre-Filed Rebuttal Testimony Amendment, pp. 97-98 (February 17, 2011); *see also* Transcript of Proceedings, Vol. III A, pp. 83-84 (March 2, 2011).
[272] Michael A. Miller, Revised Pre-Filed Rebuttal Testimony Amendment, p. 101 (February 17, 2011).

> those intangible assets recovered from the rate payers, and they should not, and are not entitled to a lower rate from assets to which they do not contribute.[273]

Moreover, TAWC asserted that as there is no overt rate base value or expense recognition in the ratemaking process for intangible assets or attributes, ratepayers have not contributed to the development of such utility assets and, thus, are not entitled to any benefits that the Company may enjoy as a result of intangible assets.[274] Mr. Miller concluded:

> Therefore, because the customers bear no risk for the costs of AWR in the rates of TAWC they are not entitled to any portion of the revenue generated by the contracts between AWR and the customers who elect to accept AWR services.[275]

The Company also disputed the necessity of an investigation concerning the affiliate relationship between TAWC and AWR.[276] Relying on the Schumaker Audit Report, the Company asserted that the management auditors had already examined the relationship between TAWC and AWR and determined that the billing methodology was reasonable.[277] On February 19, 2011, in response to Question 150 in the TRA's Fourth Set of Data Requests, the Company filed income statements related to the AWR Service Line Protection services overall and specifically to their operations in the state of Tennessee as of December 31, 2010.[278]

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[273] *Id.* at 98-99.

[274] *Id.*

[275] *Id.* at 101. Mr. Miller made similar statements in response to TRA data request Question 168:

> Q. For the same years, what was the net effect on TAWC's financial results from the agreement with AWR?
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> A. The revenue from AWR is recorded in account number 403001.AW21 (above the line) and is included in the going-level revenue of this case. Therefore, the revenue from AWR serves to lower the amount of revenue required from the Company's regular water service tariffs. The Company does not track the incremental cost of billing and collecting services for AWR (or for any other third party billing customer, i.e. City of Chattanooga). Because TAWC would have to read the meters, print the bills, mail the bills, and collect the bills even if the third party billing contracts did not exist, other than the small incremental costs of third party billing and collecting (which is automated), the cost is well below the 40.5¢ charged for the service.

See TAWC's Responses to the TRA's Fifth Set of Data Requests, Question 168, TN-TRA-05-Q168 (February 22, 2011).

[276] *Id.* at 102; *see also TAWC's Post-Hearing Brief in Support of Its Petition to Change and Increase Certain Rates and Charges,* p. 25 (March 21, 2011).

[277] *Id.*

[278] TAWC's Responses to the TRA's Fourth Set of Data Requests, Question 150, with attached schedules TN-TRA-04-Q150-ATTACHMENT (February 18, 2011).

In fixing just and reasonable rates, the Authority adheres to its precedent and longstanding regulatory policy of looking beyond its regulated utility to consider the impact of the unregulated operations of its affiliate and parent companies.[279] Review of the record demonstrates that, contrary to TAWC's position, by contracting to provide its name and goodwill to AWR, TAWC transferred valuable intangible assets to an affiliate.[280] The regulatory consequences of such a transfer have been broadly recognized: "Where a utility derives benefit from the use of a non-rate-based asset paid for by the ratepayers, [the regulatory commission] may allocate part of the cost borne by the ratepayers to the shareholders."[281] Therefore, "[i]nsofar as the ratepayers have borne the costs for creating value in [the utility's] name and reputation, the ratepayers are entitled to a prudent use of those assets."[282]

In addition, notably under the heading "Notification of Claim," TAWC provided the services of its employees to AWR apart from billing and collection. This type of practice carries with it similar opportunities for improper subsidy:

> Regulated utilities also subsidize their subsidiaries and affiliates when the expertise and experience of the utilities' employees are placed at the disposal of the subsidiaries for consultation and advice. Since ratepayers have paid for these human resources through training, salaries, bonuses and other incentive programs, the diversion of employee resources on subsidiary and affiliate matters imposes costs on the ratepayers.[283]

Accordingly, it has been held that

> it is in the public interest to require [an unregulated affiliate] to compensate [a regulated utility] for the many intangible benefits its receives, including, but not limited to the following: the use of the [utility's] name; the use of the [utility's]

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[279] *See, e.g., TPSC v. Nashville Gas Company,* 551 S.W.2d 315 (Tenn. 1977) (holding that Commission is not bound to observe corporate charters, form of corporate structure, or stock ownership in regulating a public utility and in fixing fair and reasonable rates for its operations).

[280] *See In re: Affiliated Activities, Promotional Practices and Codes of Conduct of Regulated Gas and Electric Companies*, Maryland Pub. Serv. Comm'n, Case No. 8820, *Order* (July 1, 2000); *US West Communications, Inc. v. Washington Utils. and Transp. Comm'n*, 949 P.2d 1337, 1351 (Wash. 1997) (citing cases).

[281] *Rochester Tel. Corp. v. Pub. Serv. Comm'n of New York*, 660 N.E.2d 1112, 1117 (N.Y. 1995), *cited in BellSouth Advertising and Publ'g Corp. v. Tennessee Regulatory Auth.*, 2001 WL 134603, *42 (Tenn. Ct. App. Feb. 16, 2001) (Cottrell, J., dissenting), *rev'd* 79 S.W.3d 506 (Tenn. 2002).

[282] *Rochester Tel.*, 660 N.E.2d at 1117.

[283] *Id.*

> logo; reliance on the [utility's] reputation; immediate access to financing; and the ability to capitalize, through contractual arrangements, on a trained, skilled workforce.[284]

In setting TAWC's rates, the TRA is empowered to assess the adequacy of compensation for these benefits and to take steps to ensure that TAWC's customers are not being made to subsidize a non-regulated company without proper compensation. As stated by the Supreme Court of Washington, "[t]he general rationale for [a regulatory] Commission's authority to review transactions between affiliated companies is fear of collusion in the absence of arm's-length dealings."[285] The Court further stated:

> It does not matter . . . whether the utility paid the affiliate too much money for too little service or property, or whether . . . the utility gave the affiliate something of far greater value than the affiliate paid for in return. The effect in either situation is to give to the shareholders of the affiliate something of value at the expense of the ratepayers of the utility.[286]

These statements are consistent with Tennessee law, which recognizes the TRA's ability to exert jurisdiction over non-regulated affiliates of regulated utilities when necessary for proper ratemaking. As the Tennessee Supreme Court stated over thirty years ago, "a regulatory body, such as the Public Service Commission, is not bound in all instances to observe corporate charters and the form of corporate structure or stock ownership in regulating a public utility, and in fixing fair and reasonable rates for its operations."[287]

TAWC's implementation of the *Service Agreement* with AWR does not adequately compensate TAWC's customers for the disposition of intangible assets or for employee effort and expertise. First, TAWC's statement that it incurs no costs in providing its name and goodwill to AWR lacks credibility. Second, and more importantly, TAWC's implementation of the service contract deprives its customers of proper compensation. Although TAWC provides

[284] *United Tel. Long Distance, Inc. v. Nichols*, 546 So.2d 717, 719 (Fla. 1989).
[285] *US West*, 949 P.2d at 1348.
[286] *Id.*
[287] *Tennessee Pub. Serv. Comm'n v. Nashville Gas Co.*, 551 S.W.2d 315, 319 (Tenn. 1977), *quoted in BellSouth Advertising and Publ'g Corp. v. Tennessee Regulatory Auth.*, 79 S.W.3d 506, 516 (Tenn. 2002) (recognizing the potential detriment to ratepayers in dealings with non-regulated affiliates).

billing and collection services for which it receives compensation from AWR, TAWC plainly provides other services as well. For example, TAWC has contracted to "manage and direct the distribution of informational and promotional materials regarding the [AWR] Program to [TAWC's] customers." The *Service Agreement* also provides that "[s]hould a Utility associate, as a part of his/her normal duties, determine that a Utility customer has a covered occurrence with the Customer's water or sewer service line, the Utility associate shall notify AWR by calling a toll-free telephone number to be supplied by AWR."

The fact that the *Service Agreement* separates AWR's compensation to TAWC into two components, a fee of $.405 per bill and a fee of 115% of fully distributed costs, acknowledges that TAWC is providing something of value to AWR other than billing and collection. The use of a fully distributed cost method of allocating costs between a regulated utility and its non-regulated affiliate has been deemed acceptable.[288] However, TAWC's position that it "incurs no additional costs" to provide these services is inconsistent with the provision that the fee paid by AWR for services other than billing and collection—services that are clearly part of the *Service Agreement*—will be based on TAWC's fully distributed costs of providing the service. Put simply, TAWC is not distributing the costs between itself and AWR as the *Service Agreement* requires.

More than one option exists for the appropriate regulatory treatment of a utility's disposition of a regulatory asset. One is the imputation of a royalty, an approach suggested by Ms. Dismukes and adopted in some instances.[289] Another may be the use of a contract calling for payment of fully distributed costs, properly applied.[290] TAWC's position, namely, that it incurs no additional costs and therefore has no costs to report, leaves the TRA without sufficient

[288] *See, e.g., In re: Affiliated Transactions*, 183 P.U.R.4th 277 (Md. P.S.C. February 23, 1998).
[289] *See, e.g., In re: St. Lawrence Gas Co., Inc.*, 183 P.U.R.4th 457, New York Pub. Serv. Comm'n, Case No. 97-G-0409, *Order* (January 22, 1998).
[290] This is the approach endorsed by the National Association of Regulatory Utility Commissioners ("NARUC") for allocating indirect costs: "The general method for charging indirect costs should be on a fully allocated cost basis." ROBERT L. HAHNE & GREGORY ALIFF, ACCOUNTING FOR PUBLIC UTILITIES, § 19.03[4][d] (2011).

information upon which to base a royalty. At the same time, this position denies TAWC's customers adequate compensation for the intangible assets.

Faced with the Company's broad dismissal of the AWR issue, the panel decided to impute to TAWC the net income generated from AWR's Tennessee water and sewer line protection programs.[291] This will insure that TAWC's regulated customers are adequately compensated for establishing the value of the asset TAWC transferred. While Ms. Dismukes's conception of this issue is basically sound, the TRA cannot accept her recommendation to impute $1,071,281, as this figure is based upon the total revenue of AWR from all water systems, not just those related to TAWC. Moreover, during cross-examination, Ms. Dismukes admitted that imputing the earnings of AWR's Tennessee-specific operations to the regulated side would be appropriate.[292] Accordingly, the panel concluded that the $306,611 net income generated from AWR's Tennessee water and sewer line protection programs shall be imputed to TAWC.

V(B) EXPENSES

V(B)1. SALARIES AND WAGES

The Company forecasted Salaries and Wages Expense of $5,680,299.[293] For current employees, wages for the twelve months ended March 31, 2010 were adjusted to account for the wage level to be paid during the attrition year.[294] The Company calculated the attrition year wage levels by prorating known wage rate increases that will occur during the attrition period.[295] For TAWC Union employees, whose current contract expires on October 31, 2011, the Company assumed a 3% increase effective November 1, 2011 consistent with the Union contract for the

[291] The use of imputation of income is broadly supported in regulatory decisions. *See US West*, 949 P.2d at 1351 and n. 9 (citing cases).
[292] Transcript of Proceedings, Vol. II C, p. 292 (March 1, 2011).
[293] *Petition*, Exhibit No. 2, Schedule 3 (September 23, 2010).
[294] *Id.* at 7.
[295] *Id.*

last five years.[296] For non-Union employees and current salaried employees, the Company calculated the rate based on a 3% wage increase to take effect on January 1, 2011.[297]

The Company sought to expand its employee level from the 109 employees accepted for ratemaking purposes in Docket No. 08-00039 to 110 employees.[298] According to TAWC witness Mr. Watson, the employee level of 110 reflects the number needed and required to meet the expected service levels during the attrition year.[299] Mr. Watson stated that each position had particular responsibilities that played an integral role within the Company; however, due to natural workforce turnover and a recently unplanned termination of ten employees, there were vacant positions.[300] These factors brought TAWC's actual employee numbers down, but TAWC was working diligently to fill the remaining positions.[301] Mr. Watson testified that as of the week of the hearing in this rate case TAWC's employee count was 108.[302]

The Company used a capitalization rate[303] of 15.83% to determine the amount of Salaries and Wages charged to operations and maintenance ("O&M") expense, based on the actual twelve-month average of capitalized labor as of March 2010 (the end of the test period used by TAWC).[304] The Company included Annual Incentive Plan ("AIP") costs of $146,640 in Salaries and Wages Expense. The Company stated that its AIP was changed in 2009 to make the entire individual employee AIP award applicable to each eligible employee's individual goals, which are not tied to the financial performance of TAWC or AWW.[305] The Company also stated that its incentive compensation program is part of its overall compensation plan and was established

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[296] *Id.* at 8.
[297] *Id.*
[298] John S. Watson, Pre-Filed Direct Testimony, p. 21 (September 23, 2010).
[299] John S. Watson, Pre-Filed Rebuttal Testimony, pp. 5-6 (February 8, 2011).
[300] *Id.* at 6.
[301] *Id.* at 6-7.
[302] Transcript of Proceedings, Vol. III A, p. 76 (March 2, 2011).
[303] The capitalization percentage represents the actual time charged to capital projects. The amount of capitalized salaries and wages removed from salaries and wages expense is accounted for (recovered) in rate base.
[304] TAWC's Responses to the TRA's Data Requests Dated September 20, 2010, TRA-01-Q031-ATTACHMENT, p. 2 (September 24, 2010).
[305] Michael A. Miller, Pre-Filed Rebuttal Testimony, p. 80 (February 8, 2011).

to motivate better employee performance. The overall compensation plan is claimed to be market-driven to result in benefits to TAWC's customers. Mr. Miller stated that a "performance based culture does benefit the customer, the employee (who meets high performance goals) and the shareholder."[306]

The CAPD forecasted Salaries and Wages Expense of $4,915,111 for the attrition period.[307] The CAPD argued that TAWC historically has not achieved or maintained the employment levels it forecasted.[308] The CAPD, therefore, opted to use the actual employee level of 104.[309] The CAPD priced out Salaries and Wages Expense using actual wage rates per employee, actual overtime hours as of September 2010, prospective payroll increases as of January 1 of each year pursuant to the Company's policy for salary and non-Union employees, and a 3% annual pay increase on November 1 each year for Union employees, pursuant to their contract.[310] Secondly, the CAPD eliminated 70% ($102,646) of the AIP costs from Salaries and Wages Expense.[311] The CAPD stated that 70% of the incentive payroll claimed by TAWC is based on financial performance measures and opined that any increase in regulated earnings will benefit solely the employees and the shareholders at the expense of the ratepayer.[312] The CAPD stated that it does not object to a mechanism that provides a reward for TAWC's employees for increasing earnings from regulated operations; however, the cost should be charged to those who reap the benefits, namely, the shareholders, and not the ratepayers.[313] The CAPD further noted that this treatment of incentive payroll is in accordance with established TRA precedent and decisions in several other States (Louisiana, Kentucky, Idaho, Connecticut, Illinois and

[306] *Id.* at 81.
[307] Terry Buckner, Pre-Filed Direct Testimony, Exhibit 1, Schedule 5, p. 5 of 9 (January 5, 2011).
[308] *Id.* at 4.
[309] *Id.* at 17.
[310] *Id.* at 13.
[311] *Id.* at 18.
[312] *Id.* at 19.
[313] *Id.*

Oklahoma) which have recently disallowed or limited plans of this type.[314] Additionally, the CAPD used a capitalization percentage[315] of 20.57%, which the CAPD based on the actual average capitalization rate TAWC experienced for the twelve months ended December 31, 2008.

The Union supported TAWC's request for approval to recover the "fully loaded and labor-related expenses" associated with 110 full-time employees but conditioned its support on a requirement that the Company maintain its full-time employee workforce at the 110-person level at all times.[316] The Union based its position on the assertion that (1) the Company testified that it is unable to conduct short and long-term activities in an efficient and cost-effective manner; (2) information provided by the Company showed that the current workforce is composed of a lower number of employees than previously accepted by the Authority; (3) TAWC has not maintained a union-represented workforce that is consistent with the level authorized by the authority; and (4) TAWC acknowledged that its current workforce is insufficient for the cost-effective conduct of either short-term or long-term activities, including valve maintenance.[317]

The Union further testified that TAWC's failure to conduct a valve operation and maintenance program could be significant in times of emergency situations, since the valve maintenance program helps to ensure easy valve location and proper functioning. A failure of this kind could have ripple effects leading to additional customer service disruptions in a larger area, continued water leakage, and considerable damage.[318] Moreover, the Union focused extensively on presenting evidence concerning the condition of valves and valve maintenance by TAWC and related these issues to employee levels at TAWC.

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[314] *Id.*
[315] This represents the percentage of employee time spent working on capital projects.
[316] James Lewis, Pre-Filed Direct Testimony, pp. 2-4 (January 5, 2011).
[317] *Id.* at 3.
[318] *Id.* at 15-16.

As this discussion makes evident, the valve and valve maintenance issues brought by the Union became a central focus in this rate case in determining the proper employee levels at TAWC. Initially, these issues were raised by the Union through the Pre-filed Testimony of James Lewis, which was filed on January 5, 2011. Mr. Lewis, who is National Senior Representative for UWUA, Region II, is responsible for handling grievances, arbitrations, and contract negotiations in Florida, Maryland, Pennsylvania, Tennessee, Virginia and West Virginia, including in relation to the unionized portion of the workforce at TAWC.[319]

Attached to Mr. Lewis's pre-filed testimony was a written statement by Mr. Haddock concerning employee levels, valves and valve maintenance at TAWC. As stated previously, this statement was signed by Mr. Haddock but not notarized, yet the Union referred to it as an "affidavit." Thereafter, the Union filed a *Motion to Substitute Affiant* on February 7, 2011 to have a former employee, Mr. Blevins, adopt Mr. Haddock's statements. Mr. Blevins was Field Operations Supervisor for TAWC from 1992 until November 2010. The Hearing Officer denied the Union's motion by Order issued on February 25, 2011, but the Union raised its objection again on February 28, 2011,[320] the first day of the Hearing in Chattanooga, through a *Petition for Appeal of the Hearing Officer's Initial Order*.

The panel voted to uphold the Hearing Officer's Order denying the Union's motion to substitute Mr. Blevins for Mr. Haddock, but the panel allowed the UWUA to call Mr. Haddock as a witness to attest to his own statement regarding TAWC valves. However, the panel also stated that if Mr. Haddock was going to be unavailable, testimony on valves should be heard from Mr. Blevins, having been informed that he would be available during the hearing.[321] Mr. Haddock was subsequently discovered to be unavailable because he was in Washington State and could not return to Chattanooga in time for the hearing. Since TAWC witness Mr. Watson

[319] *Id.* at 1-2.
[320] Transcript of Proceedings, Vol. I A, p. 49 (February 28, 2011).
[321] Transcript of Proceedings, Vol. II A, p. 6 (March 1, 2011).

had provided pre-filed rebuttal testimony on the valve issue, the panel determined that TAWC would not be unduly prejudiced[322] by the calling of Mr. Blevins, whom TAWC would have an opportunity to cross-examine. The panel upheld the Hearing Officer's ruling striking the portion of Mr. Lewis's statement that referred to Mr. Haddock's statement and excluding the signed statement of Mr. Haddock attached to Mr. Lewis's testimony (UWUA Exhibit 11).[323]

During the public comment period, Mr. Blevins offered comments specifically about a water main break that had occurred in Chattanooga the previous week and the problems TAWC has experienced with its valves.[324] Mr. Blevins discussed TAWC's valve inspection program, staffing, and his knowledge concerning its valve problems.[325] Additionally, as a result of the panel's determination that the valves and valve inspection program was important in this proceeding and testimony concerning this issue needed to be in the record, Mr. Blevins was permitted to testify on the record based on his own personal knowledge of TAWC's valve program. TAWC was also permitted to cross-examine Mr. Blevins.[326]

Also testifying for the Union, Mr. Lewis contended that TAWC's workforce level is not sufficient to continue to ensure safe, reliable, and high quality water services to customers [327] and that even if the TRA approves the employee level TAWC was requesting, TAWC may not fully staff its operations in the future.[328] Mr. Lewis suggested requiring TAWC to submit quarterly reports to the TRA showing both its authorized and its actual employment levels. Further, if TAWC should fail to maintain a workforce level consistent with the authorized number of employees, TAWC should be penalized.[329] This would serve to ensure that TAWC actually

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[322] *Id.* at 7.
[323] Transcript of Proceedings, Vol. IV D, pp. 246-247 (March 3, 2011).
[324] *Id.* at 281.
[325] Transcript of Proceedings, Vol. I C, pp. 329-330 (February 28, 2011).
[326] *Id.* at 331-332.
[327] James Lewis, Pre-Filed Direct Testimony, p. 6 (January 5, 2011).
[328] *Id.* at 4.
[329] *Id.*

employs the number of employees that it has requested and, indeed, that it needs.[330]

Testifying for TAWC, Mr. Watson explained that workforce turnover had played a significant role in determining employee levels, and TAWC has been unable to avoid having unfilled positions.[331] Also, turnover at TAWC has been due to retirement, resignations, severance, terminations for cause, deaths, or other events beyond the Company's control, such as medical leave, military duty or personal relocations.[332] Mr. Watson stated that TAWC anticipated having employee levels of 110 full-time equivalents ("FTEs") for 2010-2011 on or about February 28, 2011.[333] TAWC had hired five additional employees, and three additional candidates had accepted offers of employment and were to be hired the week of February 21, 2011.[334]

In his rebuttal testimony, Mr. Watson stated that TAWC has had an ongoing valve inspection program in Tennessee for the past twelve years.[335] In addition, TAWC had invested in a new vehicle that was designed and equipped to provide a comprehensive approach to valve exercising and inspection, and employees have been trained on its use and operation,[336] TAWC keeps an extensive paper records system that contains distribution system valve information, valve maps, valve numbers, construction records, and valve inspection records, similar to a fire hydrant database.[337]

TAWC indicated that it would be willing to provide the number of employees on a quarterly report to the Authority.[338] The Consumer Advocate supported this idea.[339] Mr. Watson also stated that TAWC performs preventive valve maintenance, having set specific goals for

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[330] *Id.*
[331] John S. Watson, Pre-Filed Rebuttal Testimony, p. 8 (February 8, 2011).
[332] *Id.*
[333] *Id.*
[334] *Id.*
[335] John S. Watson, Pre-Filed Rebuttal Testimony, p. 26 (February 8, 2011).
[336] *Id.*
[337] Transcript of Proceedings, Vol. IV D, pp. 301-302 (March 3, 2011).
[338] Transcript of Proceedings, Vol. III A, pp. 34-35 (March 2, 2011).
[339] *Consumer Advocate and Protection Division's Post-Hearing Brief*, p. 22 (March 21, 2011).

2009 and 2010,[340] and had met its valve inspection/operation goals in 2010 except for smaller valves. According to Mr. Watson, TAWC was close to meeting its goal fully but was prevented by an employee's retirement.[341] Mr. Watson testified that additional employees had been hired, and once employee levels were at 110 FTEs, TAWC would be able to meet its valve maintenance goals by the end of 2011.[342]

The Company argued that it had been able to maintain its valves effectively, but it could not continue to perform proper valve operation and maintenance in the longer term without the additional staff requested in its *Petition*.[343] Until this point, TAWC had been able to sustain its valve maintenance program because of the weak economy and a decrease in housing starts in its service area and by shifting employees in other areas to valve maintenance functions.

During cross-examination, Mr. Watson agreed that TAWC's valve exercising, maintenance and inspection program is part of its obligation to operate its system in accordance with good utility practice and an appropriate program for a water utility.[344] Mr. Watson stated that he was not aware of any federal or state mandates for valves or valve maintenance.[345]

Mr. Blevins testified that some valves in TAWC's system had been in disrepair for a number of years.[346] He also stated that TAWC did not have enough employees handling valve maintenance, and often he had trouble finding valves that were sufficiently operational to allow TAWC to carry out a repair. [347] He stated that on occasion he had to conduct repairs without reducing water pressure because he was unable to turn off an inoperable valve.[348] He also testified that TAWC was aware that valves were inoperable and that valve issues had been

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[340] John S. Watson, Pre-Filed Rebuttal Testimony, pp. 26-27 (February 8, 2011).
[341] *Id.* at 27.
[342] *Id.* at 28.
[343] *Id.* at 27.
[344] Transcript of Proceedings, Vol. IV D, p. 319 (March 3, 2011).
[345] *Id.* at 319.
[346] *Id.* at 290-291.
[347] *Id.* at 291.
[348] *Id.* at 295.

discussed during TAWC departmental meetings and group discussions.[349]

In its post-hearing brief, TAWC claimed that the Intervenors were attempting to shift the focus to a variety of irrelevant topics during this rate case, such as TAWC's policies and procedures for inspecting and maintaining the valves.[350] TAWC asserted that Mr. Watson's testimony had disproved the Intervenors' allegations of deficiencies in the valve maintenance program.[351]

The Union replied in its post-hearing brief that the Company's alleged staffing and maintenance deficiencies compromise the quality of service it provides to its customers.[352] The Union stated that its main concern was the potential inclusion in rates of expenses associated with all eighty-two hourly employees being included in the Company's 110 FTE level.[353]

The Consumer Advocate recommended that TAWC be allowed only 104 employees, based on the average number of employees during the test period ended September 2010, because TAWC had a track record of not maintaining authorized employee levels.[354] The Consumer Advocate later modified its position to state that the maximum number of employees should be 107, and the TRA should require a monthly report of employees by name and position.[355]

Tenn. Code Ann. § 65-4-103 provides, in pertinent part, that the TRA has an obligation in setting rates "to take into account the safety, adequacy and efficiency or lack thereof of the service or services furnished by the public utility." Tenn. Code Ann. § 65-4-115 further provides that no public utility shall "provide or maintain any service that is unsafe, improper, inadequate or withhold or refuse any service which can reasonably be demanded and furnished when

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[349] *Id.* at 296.
[350] *Tennessee American Water Company's Post-Hearing Brief in Support of Its Petition to Change and Increase Certain Rates and Charges*, p. 118 (March 21, 2011).
[351] *Id.* at 171.
[352] *Id.*
[353] *Id.*
[354] *Consumer Advocate and Protection Division's Post-Hearing Brief*, p. 21 (March 21, 2011).
[355] *Id.*

ordered by the Authority." TRA Rule 1220-4-3-.42(2) requires that a utility "shall make all reasonable efforts to prevent interruptions of service and when such interruptions occur shall endeavor to re-establish service with the shortest possible delay consistent with the safety to its customers and the general public." Both the noted uncertainties surrounding employee levels and the related issue of adequate valve maintenance implicate these regulatory requirements, and the TRA must necessarily consider these issues in setting TAWC's rates for water service.

Based on the record and foregoing considerations, a majority of the panel sets $5,279,477 for Salaries and Wages Expense during the attrition period.[356] As further discussed below, the Salaries and Wages Expense amount that is calculated by the majority utilizes a price out that consists of 110 employees, reflects a deduction of 20% of the current salary of the newly created Government Affairs Specialist position, a 50% reduction ($67,619) to AIP incentive payroll, the elimination in full of allocations to the Long Term Incentive Plan ("LTIP") ($11,403), and a 20.57% capitalization rate.

The Authority agrees that the calculation of Salaries and Wages Expense appropriately begins with 110 employees, but deducts the portion of the current salary of the Government Affairs Specialist that correlates to time spent performing the job function of political lobbying or legislative/governmental actions advocacy.[357] The Company's witness, Mr. Watson, TAWC President, testified that the Government Affairs Specialist position was a newly created position, which replaced a previously contracted service position, filled by the Company on August 30,

[356] Director Roberson did not vote with the majority and files a separate opinion explaining his position. Additionally, Director Roberson voted to exclude from the calculation the position of Finance Manager because that employee's functions duplicate a portion of the function for finance services that are provided to TAWC by AWWSC. This would reduce TAWC's revenue requirement by $120,333. Transcript of Proceedings, p. 71 (April 4, 2011).

[357] Agreeing with the CAPD's position, Director Roberson moved to amend the pre-filed motion filed by Chairman Freeman to reflect a maximum allocation of 107 employees. Director Roberson derived this employee allocation based on the actual number of current TAWC employees (108) testified by Mr. Watson, President of TAWC, excluding the Government Affairs Specialist position and full salary paid to Mr. Kino Becton, TAWC's newly hired Government Affairs Specialist, who is a registered lobbyist in the State of Tennessee. The results of Director Roberson's amendment, had it succeeded, would have been to reduce the Salary & Wages Expense by an additional $163,944. *See,* Transcript of Proceedings, pp. 68-69 (April 4, 2011).

2010.[358] The duties of the Government Affairs Specialist include working closely with municipal officials, customers, and constituents on local issues, building relationships with state officials concerning activities, plans, and projects of interest to the Company, improving the Company's management of local and state issues, and monitoring changes in municipal, county, state and federal laws and regulations.[359] Mr. Watson estimated that 20% of the Government Affairs Specialist's time would be spent lobbying on behalf of TAWC and its customers.[360]

It is a well-established and long-standing policy of the TRA to disallow expenses related to lobbying when setting utility rates.[361] Consistent with its own policy and precedent, and that of most other state regulatory commissions throughout this country, the majority finds that expenses related to lobbying are expended for the benefit of the Company first and foremost, and are not necessary for the provision of safe and adequate service. Therefore, the majority concludes that insofar as 20% of the Governmental Affairs Specialist's time will be spent lobbying, it is reasonable for ratemaking purposes to deduct a proportional percentage of the current salary allocated to that position (20%).[362]

In addition, the Company testified that in 2009 and 2010, it scaled back some of its planned capital investment projects due to financial constraints following its last rate case order.[363] In light of the reduced completion of capital investment projects, the calculations for plant additions appear unusually low in the test periods used by both the Company and the CAPD and the Company's capitalization rate does not accurately reflect typical activity in this

[358] John S. Watson, Pre-Filed Direct Testimony, p. 23 (September 23, 2010).
[359] *Id.* at 23-24.
[360] TAWC's First Supplemental Responses To The First Discovery Request And First Responses To The Supplemental Discovery Request Of The CAD Questions 53-126, TN-CAPD-SUPPLEMENTAL-Q086 (December 2, 2010).
[361] Reaffirming its policy and practice of disallowing lobbying expenses in ratemaking, the Tennessee Public Service Commission, which was the predecessor agency of the TRA, stated, "We still believe that the first obligation of the company's lobbyist is to act in a manner that is beneficial to the company, which may or may not be beneficial to the company's customers. We will continue our position that this is an improper expense for rate-making purposes." *In re S. Cent. Bell Tel. Co.,* 22 P.U.R.4th 281, 297 (Dec. 30, 1977); *see also,* 48 P.U.R.4th 493, 496 (Sept. 20, 1982).
[362] TAWC's Responses to the TRA's Data Requests Dated September 20, 2010, TN-TRA-01-Q013, Workpaper Labor 12 months ended 2010 (September 24, 2010).
[363] John S. Watson, Pre-Filed Direct Testimony, pp. 13-14 (September 23, 2010).

category. Therefore, the panel elects to use the CAPD's capitalization percentage of 20.57%. This percentage is the actual capitalization rate for the twelve months ended December 31, 2008, a period that better reflects normal plant additions.

The Company confirmed that its reported AIP amount of $146,640 includes an LTIP of $11,403 of Equity Compensation, leaving a balance of $135,237 as the intended AIP amount. The TRA disagreed with the Company's position that the total of AIP and LTIP costs ($146,640) should be included in Salaries & Wages Expense. However, the CAPD's proposal to remove 70% of these costs based on financial targets is also unsatisfactory because this is the overall amount of AIP available for payment in a given year, and once determined, employee performance is no longer tied to the overall financial goals of AWW.[364]

The TRA determined that one half of AIP ($67,619) should be included in Salaries and Wages, since both TAWC and its customers benefit from AIP through higher financial returns for the Company. Regarding the LTIP plan, this program provides executive or director compensation based on the financial performance of AWWC's stock price. No just and reasonable basis exists for charging ratepayers this type of compensation, which rewards TAWC solely on the basis of financial performance. For ratemaking purposes, therefore, LTIP should be eliminated.

Further, the panel required TAWC to submit semi-annual reports of its staffing levels to the TRA's Utility Division Chief. Specifically, each such report should include (1) the actual number of full-time equivalent employees for the previous period, by month; (2) an explanation of any differences between authorized and actual FTEs; and (3) the date(s) TAWC expects to fill any vacant positions. The panel also required the Company to submit a semi-annual report to the Utility Division Chief regarding its Valve Operation and Maintenance Program. Each semi-annual report should also include (1) the number of employees assigned to the valve program, by

[364] Michael A. Miller, Pre-Filed Rebuttal Testimony, pp. 80-81 (February 8, 2011).

month; (2) the target number of larger and smaller valves scheduled during the preceding period for inspection/operation and maintenance, by month; (3) the number of valves actually inspected/operated and maintained during the report period, by month; (4) the number of valves found to be in need of repair or replacement, by month; (5) the date for repair or replacement of such valves; and (6) if TAWC decided not to repair or replace those valves, the number of valves that were not repaired or replaced and the reason for not doing so.

V(B)2. PURCHASED WATER

The Company forecasted Purchased Water Expense of $50,962. This amount represents the Company's 2011 purchased water budget.[365] The CAPD originally forecasted $47,708 for the attrition period.[366] This amount is based upon the Company's Income Statements for the twelve months ended September 30, 2010[367] and increased by the CAPD's growth/inflation factor of 1.51%,[368] which was later corrected to 1.40% growth factor.[369] The effect of this adjustment was to decrease Purchased Water Expense from $47,708 to $47,657.[370] On March 1, 2011, the CAPD filed amended testimony changing the residential customer growth factor from 0.89% to 1.05% (utilized to project revenues)[371] and this caused the CAPD's growth/inflation factor to change from 1.40% to 1.48%.[372] The effect of this adjustment was to increase Purchased Water Expense from $47,657 to $47,692.[373]

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[365] TAWC's Responses To The TRA's Second Data Requests Dated October 26, 2010, TN-TRA-02-Q092D-Purchase Water Summary, p. 1 of 28 (December 1, 2010).
[366] Terry Buckner, Pre-Filed Direct Testimony, Exhibit 1, Schedule 5, p. 5 of 9 (January 5, 2011).
[367] Terry Buckner, Pre-Filed Direct Testimony, Workpaper E-PW (January 5, 2011).
[368] Terry Buckner, Pre-Filed Direct Testimony, p. 12 (January 5, 2011).
[369] Terry Buckner, Non-Confidential Direct Testimony Amendment, Workpaper AMENDED E-PW (January 31, 2011).
[370] *Id.*
[371] John Hughes, Amendment to Amended Testimony filed February 25, 2011, Workpaper R-CUSTOMER GROWTH (March 1, 2011).
[372] Terry Buckner, Second Amendment to Direct Testimony, Workpaper AMENDED E-PW (Hearing Exhibit 90) (March 8, 2011).
[373] Terry Buckner, Second Amendment to Direct Testimony, Amended Exhibit 1, Schedule 5, p. 5 of 9 (Hearing Exhibit 90) (March 8, 2011).

The Authority adopts $47,692 as the Purchased Water Expense projection for the attrition period. The panel reasons that the Company provided its budgeted amount but did not supply supporting documentation for its number, and the CAPD's projection is based upon known and measurable changes and accounts for inflation.

V(B)3. FUEL AND POWER

Fuel and Power Expense is the amount of fuel and power (electricity) necessary to pump TAWC's water to its customers. In order to calculate Fuel and Power Expense, the amount of water to be pumped, adjusted for an allowable water loss percentage, has to be determined. The Company projected total Fuel and Power Expense of $2,511,238 for the attrition period.[374] The calculation was based upon the expected volume of water pumped into the system during the attrition year, and the cost to pump and treat the water.[375] The Company estimated attrition year water sales of 9,878,253,000 gallons (13,171,004 CCF)[376] adjusted by a three year average of lost or unaccounted-for water of 22.70% to arrive at system delivery.[377] The Company used Chattanooga Electric Power Board ("EPB") tariff rates effective on October 1, 2009 adjusted for expected increases for the attrition year as indicated by the EPB. The Company stated that it had contacted an EPB representative during the summer of 2010 to determine rates going forward and was advised to expect 6% increases on both October 1, 2010 and October 1, 2011, along with Fuel Cost Adjustments that would continue monthly in 2010 and could level off or slightly decrease.[378] Later, the Company adjusted its projected attrition year Fuel and Power Expense

[374] Sheila A. Miller, Pre-Filed Direct Testimony, p. 10 (September 23, 2010).
[375] *Id.* at 9.
[376] 13,171,004 CCF * 7.5 = 9,878,253,000 gallons
[377] TAWC's Responses to the TRA's Data Requests Dated September 20, 2010, TN-TRA-01-Q013-Fuel and Power, p. 3 (September 24, 2010).
[378] John S. Watson, Pre-Filed Direct Testimony, pp. 26-27 (September 23, 2010).

from $2,511,238 to $2,575,657. The Company increased Fuel and Power Expense by $64,419, as a result of using the updated EPB November 2010 Fuel Cost Adjustment.[379]

The Consumer Advocate projected total attrition period Fuel and Power Expense of $2,410,868.[380] The CAPD calculated this cost based on water sales volumes of 13,582,557 CCF[381] for the attrition year. The CAPD incorporated the Fuel Cost Adjustment as of November 1, 2010 and capped the amount of lost or unaccounted-for water loss at 15%, as established by Authority Order in Docket No. 08-00039. The CAPD stated that the cap utilized for lost or unaccounted-for water was the primary difference between the Company and CAPD forecasts of Fuel and Power Expense.[382] On March 1, 2011, the CAPD filed amended expert witness testimony changing its calculation of water sales for the attrition period, utilized in projecting revenues, from 13,582,557 CCF to 13,508,335 CCF.[383] This adjustment decreased the CAPD's calculation of Fuel and Power Expense from $2,410,868 to $2,397,694.[384]

Water that is lost or unaccounted for in the system is water that is still pumped and treated, and TAWC still incurs an expense for the fuel and power needed to pump it. Recovery of the cost of the fuel and power incurred to pump lost or unaccounted-for water is allowed through the setting of a percentage that is then applied to determine Fuel and Power Expense.

The CRMA proposed 15% as an acceptable lost and unaccounted-for water ("UFW") percentage for use in the calculation of both Chemicals Expense and Fuel and Power Expense.[385] The CRMA chose 15% for the following reasons:

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[379] TAWC's Responses To The TRA's Second Data Requests Dated October 26, 2010, Question 113, TN-TRA-02-Q113 (December 1, 2010).
[380] Terry Buckner, Pre-Filed Direct Testimony, p. 20 (January 5, 2011).
[381] Terry Buckner, Pre-Filed Direct Testimony, Workpaper E-FP (January 5, 2011).
[382] Terry Buckner, Pre-Filed Direct Testimony, p. 20 (January 5, 2011).
[383] Terry Buckner, Second Amendment to Direct Testimony, Workpaper AMENDED E-FP (Hearing Exhibit 90) (March 8, 2011).
[384] Terry Buckner, Second Amendment to Direct Testimony, Amended Exhibit 1, Schedule 5, p. 5 of 9 (Hearing Exhibit 90) (March 8, 2011).
[385] Michael Gorman, Pre-Filed Direct Testimony, p. 4 (January 5, 2011).

1. The American Water Works Association "Survey of State Agency Water Loss Reporting Practices" indicates that a reasonable lost water factor is 15% or less;
2. The water loss factor is consistent with the Authority's ruling in Docket No. 08-00039; and
3. The cost of replacing transmission lines is included in this filing, which the CRMA believes will bring the lost water factor down to a more reasonable level.[386]

In contrast, the Company recorded an unaccounted-for water percentage of 22.93% for the twelve-month period ended March 31, 2010.

The Company's water loss increased from the 20.43% level requested in its last rate case (the twelve months ended March 2008) to the 22.70% requested in this rate case. In its testimony, the Company stated it delayed part of its scheduled investment due to its poor earnings. However, the Company included additional plant investment in this rate case. With the additional investment in plant, it is reasonable to expect a decrease in water loss from current levels. The Authority determined that the baseline water loss percentage of 15% for TAWC, the same percentage established in the 2008 rate case,[387] remains viable, and TAWC should continue to strive to meet this goal. Also, the Authority agreed with the evidence put forth by the CRMA, and supported by the CAPD, that a 15% water loss was reasonable. Accordingly, the Authority determined the Fuel and Power Expense for the attrition period to be $2,277,057. This calculation was based on the Company's normalized usage during the test period of 13,132,968 CCF,[388] the rates in effect from the Chattanooga EPB plus the March 2011 Fuel Cost Adjustment, and a 15% water loss percentage.

The Authority uses the EPB's rates, as of October 2009, for the demand cost, energy cost, and the customer charge in the fuel and power calculation for the attrition year and did not include the Company's anticipated 6% increase in EPB rates that were forecasted, but unproven,

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[386] *Id.* at 4-5.
[387] On appeal of this issue by TAWC, the Tennessee Court of Appeals affirmed the TRA's decision setting a 15% cap on UFW. *Tennessee Amer. Water Co. v. TRA*, 2011 WL 334678, * 27-28 (Jan. 28, 2011).
[388] *Petition*, Exhibit No. 4, Schedule 2 (September 23, 2010).

for implementation on October 1, 2010. Rather, EPB's actual rate on October 1, 2010 was verified, and the TRA included that $0.0063 current Fuel Cost Adjustment as of March 2011.

V(B)4. CHEMICALS

Chemical Expense is the cost of chemicals purchased by TAWC necessary to treat the water prior to consumption. The Company initially projected Chemical Expense for the attrition period of $1,069,369. The Company used the attrition year water sales of 13,171,004 CCF,[389] adjusted by a three-year average percentage of lost or unaccounted-for water of 22.70% to arrive at a system delivery amount. The Company used the estimated 2011 contract chemical prices to calculate its Chemical Expense.[390] Later, the Company decreased projected attrition year Chemical Expense by $97,447, as a result of obtaining lower actual 2011 contract prices for chlorine and sodium hydroxide (caustic soda) than originally anticipated.[391] The effect of the adjustment was to decrease Chemical Expense from $1,069,369 to $971,922.[392]

The CAPD forecasted Chemical Expense for the attrition period of $930,961.[393] The CAPD calculated this cost based on water sales volumes of 13,582,557 CCF[394] and known contract prices for 2011.[395] The CAPD capped the amount of lost and unaccounted-for water loss at 15% and stated that its treatment of this expense was consistent with the Authority's Order in Docket No. 08-00039. [396] In amended testimony filed on March 8, 2011, the CAPD changed the water sales calculation for the attrition period that it used in projecting revenues from 13,582,557 CCF to 13,508,335 CCF[397] and decreased its Chemical Expense forecast from

[389] 13,171,004 CCF * 7.5 = 9,878,253,000 gallons.
[390] Sheila A. Miller, Pre-Filed Direct Testimony, p. 10 (September 23, 2010).
[391] TAWC's Responses To The TRA's Second Data Requests Dated October 26, 2010, TN-TRA-02-Q117-Attachment 3, p. 3 (December 1, 2010).
[392] *Id.*
[393] Terry Buckner, Pre-Filed Direct Testimony, p. 21 (January 5, 2011).
[394] Terry Buckner, Pre-Filed Direct Testimony, Workpaper E-CHEM 2 (January 5, 2011).
[395] Terry Buckner, Pre-Filed Direct Testimony, Workpaper E-CHEM 1 (January 5, 2011).
[396] Terry Buckner, Pre-Filed Direct Testimony, p. 20 (January 5, 2011).
[397]Terry Buckner, Second Amendment to Direct Testimony, Workpaper AMENDED E-CHEM2 (Hearing Exhibit 90) (March 8, 2011).

$930,961 to $925,894.[398] The CAPD priced out chemicals using known prices for 2011. The CRMA proposed that a 15% lost and unaccounted-for water percentage was reasonable to use in the calculation of both Chemicals Expense and Fuel and Power Expense for the reasons previously discussed.[399]

The panel determines the Chemicals Expense for the attrition period to be $881,439. Because known and measurable changes are appropriately considered, it was necessary to include the new contract chemical prices in the calculation of the Chemicals Expense. The panel agreed with the CRMA and the CAPD that the Authority should maintain its precedent and set a lost and unaccounted-for water percentage no higher than 15%. Using 13,132,968 CCF as the Company's usage,[400] adjusting for actual contract chemical prices, and applying a 15% capped lost water percentage, the panel finds that Chemicals Expense totals $881,439 for the attrition period.

V(B)5. Waste Disposal

The Company forecasted an attrition period Waste Disposal Expense of $197,386.[401] This amount is based upon the actual amount paid during the test period ended March 31, 2010. This amount ($183,965) was adjusted to reflect a 3% rate increase from the City of Chattanooga Sanitary Board effective January 1, 2010, a 2.75% increase effective October 1, 2010, and a 2.75% increase to be effective April 1, 2011, resulting in an adjustment of $13,421 for the attrition period.[402]

The CAPD projected an attrition period Waste Disposal Expense of $172,338.[403] The CAPD used actual book values of $169,774 as of September 30, 2010, which was reported in

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[398] Terry Buckner, Second Amendment to Direct Testimony, Amended Exhibit 1, Schedule 5, p. 5 of 9 (Hearing Exhibit 90) (March 8, 2011).
[399] Michael Gorman, Pre-Filed Direct Testimony, pp. 4-7 (January 5, 2011); *see also*, 8 V(B)3, Fuel and Power.
[400] *Petition*, TAWC Test Period Normalized Billing Determinants, Exhibit No. 4, Schedule 2 (September 23, 2010).
[401] *Petition*, Exhibit No. 2, Schedule 3 (September 23, 2010).
[402] Sheila A. Miller, Pre-Filed Direct Testimony, p. 11 (September 23, 2010).
[403] Terry Buckner, Pre-Filed Direct Testimony, Exhibit 1, Schedule 5, p. 5 of 9 (January 5, 2011).

TAWC's Income Statements, as the test period Waste Disposal Expense.[404] The CAPD increased the test period book value amount by one half of its calculated customer growth factor of .89% plus an inflation factor of .76%.[405] The CAPD later amended its growth factor to 1.4%,[406] and this decreased the CAPD's projected Waste Disposal Expense from $172,338 to $172,151.[407] Thereafter, the CAPD's amended testimony filed on March 1, 2011 changed the residential customer growth factor to be utilized in projecting revenues from 0.89% to 1.05%[408] and this caused the CAPD's growth/inflation factor to change from 1.40% to 1.48%.[409] The effect of this adjustment increased the CAPD's Waste Disposal Expense projection from $172,151 to $172,279.[410]

Considering the evidence in the record and adjusting for known and measurable changes in forecasting for the attrition period, the panel finds $194,993 appropriate for Waste Disposal Expense.

V(B)6. MANAGEMENT FEES

The category of management fees consists of the charges incurred by TAWC for services provided to it by AWWSC in accordance with their 1989 Service Company Agreement. AWWSC is an affiliated service company established by AWWC to aid, assist, and advise the business operations of AWWC subsidiaries, which includes TAWC, by providing accounting, administration, communications, corporate secretarial, engineering, finance, human resources,

[404] Terry Buckner, Pre-Filed Direct Testimony, Workpaper E-WASTE (January 5, 2011).
[405] Terry Buckner, Pre-Filed Direct Testimony, p. 12 (January 5, 2011).
[406] Terry Buckner, Non-Confidential Direct Testimony Amendment, Workpaper AMENDED E-WASTE (January 31, 2011).
[407] *Id.*
[408] John Hughes, Amendment to Amended Testimony filed February 25, 2011, Workpaper R-CUSTOMER GROWTH (March 1, 2011).
[409] Terry Buckner, Second Amendment to Direct Testimony, Workpaper AMENDED E-WASTE (Hearing Exhibit 90) (March 8, 2011).
[410] *Id.*

information systems, operations, rates and revenue, risk management, and water quality services.[411] These services are billed to ratepayers at-cost to TAWC.[412]

Relevant Background

On May 15, 2007, as part of its deliberations in TAWC's 2006 rate case, the Authority allocated recovery of management fees in the amount of $3,979,825, which was an amount that was slightly lower than the $4,064,421 that TAWC had requested in its petition.[413] Further, the Authority ordered TAWC to obtain a management audit that conformed to the mandates of the Sarbanes-Oxley ("SOX") regulation.[414] The stated purposes of the audit were two-fold: to obtain an independent assessment as to 1) whether the significantly increasing costs incurred by TAWC for management fees reflected prudent decisions on the part of management, and 2) whether the allocation methodology used to charge the costs of the services to TAWC was reasonable.[415]

On March 14, 2008, along with a petition for a rate increase, TAWC filed with the Authority an audit report prepared by Booz Allen Hamilton ("BAH").[416] During the proceeding that followed, the City challenged the independence of the BAH auditor and report, and contended that the audit had not been conducted as the TRA had required, nor in compliance with SOX. After a thorough review and hearing, the Authority held that the BAH report had failed to adequately address the issue of whether the management fees at issue resulted from

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[411] *See In re: Tennessee American Water Company's Request for Proposal for a Management Audit,* Docket No. 09-00086, *Notice of Filing of Schumaker & Company's Affiliate Audit Report of Tennessee American Water Company for the Tennessee Regulatory Authority,* Schumaker & Company, Affiliate Audit Report ("Schumaker Audit Report"), p. 13 (September 10, 2010).

[412] *Id.*

[413] *See In re: Petition of Tennessee American Water Company to Charge and Increase Certain Rates and Charges so as to Permit It to Earn a Fair and Adequate Rate of Return on Its Property Used and Useful in Furnishing Water Service to Its Customers,* Docket No. 06-00290, *Order,* p. 26 (June 10, 2008).

[414] *Id.; See also* 15 U.S.C 98 (2002) (Named after Senator Paul Sarbanes and Representative Michael Oxley, who were its main architects, the Sarbanes-Oxley Act of 2002 introduced major changes in the regulation of corporate governance and financial disclosure. Effective in 2006, all publicly-traded companies were required to implement and report internal accounting controls to the SEC for compliance.)

[415] *Id.* at 27.

[416] *See In re: Petition of Tennessee American Water Company to Change and Increase Certain Rates and Charges so as to Permit It to Earn a Fair and Adequate Rate of Return on Its Property Used and Useful in Furnishing Water Service to Its Customers,* Docket No. 08-00039, *Petition* (March 14, 2008).

prudent decisions made by TAWC management, and further, that the audit had not been conducted by an independent auditor in conformity with SOX and as ordered by the TRA in Docket No. 06-00290.[417] Therefore, the Authority determined that TAWC's request of $4,335,190 in management fees was unsupported in the record, and instead allocated $3,529,933 to attrition year expense.[418] Because the Authority concluded that the audit did not comply with the TRA's directive in the 2006 rate case, it further declined to include recovery of the costs of the BAH audit in the rate case. Further, the Authority ordered TAWC to develop and submit for Authority approval, a Request for Proposal ("RFP") for a comprehensive management audit by an independent certified public accountant and set certain minimum requirements and procedural deadlines concerning the RFP.[419]

Following entry of the Authority's Order in Docket No. 08-00039, TAWC filed an appeal with the Tennessee Court of Appeals alleging, among other issues, that the TRA's decisions concerning the management audit and fees were arbitrary and capricious, an abuse of discretion, and erroneous. On January 28, 2011, the Court issued an Opinion in which it found that the decisions of the TRA were not in error, arbitrary, or capricious, but, rather, an appropriate exercise of the agency's discretion and affirmed the TRA's decisions on all of the challenges TAWC had raised concerning the management audit and fees.[420] Finding that because TAWC had failed to meet its burden of proof to show that the charges it had requested were prudent, the Court affirmed the Authority's decision to allocate management fees in an amount that was lower than had been requested by TAWC as an appropriate exercise of the TRA's discretion.[421] Further, the Court affirmed the TRA's decisions concerning its choice of methodology used to

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[417] *See In re: Petition of Tennessee American Water Company to Change and Increase Certain Rates and Charges so as to Permit It to Earn a Fair and Adequate Rate of Return on Its Property Used and Useful in Furnishing Water Service to Its Customers,* Docket No. 08-00039, *Order,* pp.18-22 (January 13, 2009).
[418] *Id.* at 18, 21.
[419] *Id.* at 21-22.
[420] *See Tennessee American Water Co. v. Tenn. Regulatory Auth.,* 2011 WL 334678, at *18-21 (Tenn. Ct. App. Jan. 28, 2011).
[421] *Id.* at *18.

forecast the fees, determinations concerning the lack of independence of BAH, TAWC's chosen auditor, the TRA's subsequent disregard of the BAH report, and disallowance of the costs related to the BAH report.[422]

After announcing its decision in Docket No. 08-00039, the Authority opened Docket No. 09-00086 to accommodate all filings related to the RFP.[423] The TRA Staff continued to work with TAWC in further developing the necessary parameters of the RFP throughout the audit proceedings, until the culmination and filing of the final report. On September 10, 2010, TAWC filed in Docket No. 09-00086 the final management audit report that had been prepared by Schumaker & Company.[424] On September 23, 2010, following a request by TAWC, the Authority entered a protective order in the docket file.[425] On September 27, 2010, TAWC filed the confidential Workpapers and Exhibits that Ms. Schumaker prepared and provided to TAWC in conjunction with the Schumaker Audit Report.[426] Despite ongoing activity in the docket, a request for intervention was not filed in Docket No. 09-00086 until January 2011.[427] On January 24, 2011, Chairman Freeman, acting as Hearing Officer, took official administrative notice in Docket No. 10-00189 of all filings that had been made in Docket No. 09-00086.

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[422] *Id.* at *19-21.

[423] *See In re: Petition of Tennessee American Water Company to Change and Increase Certain Rates and Charges so as to Permit It to Earn a Fair and Adequate Rate of Return on Its Property Used and Useful in Furnishing Water Service to Its Customers,* Docket No. 08-00039, *Order Moving Request for Proposal to New Docket* (July 16, 2009).

[424] *See In re: Tennessee American Water Company's Request for Proposal for a Management Audit,* Docket No. 09-00086, *Notice of Filing of Schumaker & Company's Affiliate Audit Report of Tennessee American Water Company for the Tennessee Regulatory Authority* (September 10, 2010). On December 9, 2010, TAWC filed a replacement disk of the Schumaker Audit Report, originally filed on September 10, 2010, asserting that the originally filed disk contained certain confidential information.

[425] *See In re: Tennessee American Water Company's Request for Proposal for a Management Audit,* Docket No. 09-00086, *Protective Order (As Modified,)* (September 23, 2010).

[426] *See In re: Tennessee American Water Company's Request for Proposal for a Management Audit,* Docket No. 09-00086, *Notice of Filing of Confidential and Proprietary Portions of Workpapers Related to Schumaker & Company's Affiliate Audit Report of Tennessee American Water Company for the Tennessee Regulatory Authority* (September 27, 2010).

[427] On January 6, 2011, following TAWC's filing of a *Motion to Approve and Adopt Schumaker & Company's Affiliate Audit Report of Tennessee American Water Company for the Tennessee Regulatory Authority*, the CAPD filed a petition to intervene in Docket No. 09-00086.

Positions of the Parties in Docket No. 10-00189

In the instant rate case, TAWC relied on the cost of service study, and the related testimony, of Mr. Patrick L. Baryenbruch, as well as, in part, upon the findings of the Schumaker Audit Report, to support its contentions that the $5,226,034 it projected in attrition period management fees were reasonable, necessary, and the result of prudent management decisions made by TAWC.[428] Through the study and testimony of Mr. Baryenbruch, the Company asserted that AWWSC's cost of $59.00 per customer was reasonable as compared to an average cost of $95.00 per customer for electric and combination electric/gas service companies.[429] In addition, TAWC had been charged the lower of cost or market for the administrative and professional services, which were vital, efficiently procured, and absent of any profit markup, resulting in substantial savings to the ratepayers and Company.[430] Further, the customer account services provided by the National Call Center are reasonable and fall below an average range of the study's electric comparison group.[431] Mr. Baryenbruch asserted that his study demonstrated that AWWSC's services are necessary, would be required even if TAWC were a stand-alone company, and that no redundancy or overlap exists in the services provided to TAWC.[432] Finally, Mr. Baryenbruch asserted that the Schumaker Audit Report affirmed his study's methodology as a reasonable approach to verifying that the service costs charged to TAWC do not harm ratepayers.[433]

TAWC also filed additional testimony prepared by Mr. Baryenbruch for the purpose of rebutting certain criticisms of Baryenbruch's study that were made by the City's witness, Ms.

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[428] Patrick Baryenbruch, Pre-filed Direct Testimony, attached Market Cost Comparison of Service Company Charges to Tennessee American Water Company 12-Months Ended March 31, 2010 (September 23, 2010).
[429] *Id.* at 4 of 8.
[430] *Id.* at 5-6 of 8.
[431] *Id.* at 6-7 of 8.
[432] *Id.* at 7 of 8.
[433] *Id.* at 7 of 8.

Kimberly H. Dismukes.[434] In response to Ms. Dismukes's criticisms concerning the use of electric and combination electric/gas companies, instead of water companies, as comparisons in analyzing the reasonableness of the service charges allocated to TAWC, Mr. Baryenbruch asserts that his methodology is reasonable because there is no publicly available cost information for water service companies.[435] In addition, very few water companies have a centralized service company arrangement, and those that do are not overseen by a single regulatory agency that requires a standard filing.[436] Further, Mr. Baryenbruch asserted that the differences in the operating and maintenance processes or functions between electric companies and water companies does not result in unreliable results because the study compares administrative and general expenses, rather than O&M expenses, which are similar across utility types.[437]

To calculate its projected management fees, the Company started with historical test-year expenses of $5.008 million, then eliminated a total of $46,230 in non-recurring and other properly excluded expenses to arrive at a normalized historical test-year amount of $4.962 million.[438] Next, the Company increased its normalized historical test-year amount using an annual inflation rate of 3% and adjusted the amount to account for the twenty-one (21) months remaining to the end of the attrition year.[439] The resulting calculation of $5.226 million in AWWSC charges for management fees was included in TAWC's rate case filing.[440]

TAWC's forecast of its 2011 attrition year management fees represented an increase of $1,659,901, or 46.55%, over and above its 2005 management fee expenses.[441] The Company asserted that compelling and justifiable reasons existed for the increases, which had occurred

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[434] Patrick Baryenbruch, Rebuttal Testimony of Patrick Baryenbruch (February 8, 2011).
[435] *Id* at 4-5.
[436] *Id* at 5.
[437] *Id* at 5-16.
[438] Michael A. Miller, Pre-Filed Direct Testimony, p. 40 (September 23, 2010). Also note, as discussed previously in this *Final Order,* the Company used a historical test period ending March 31, 2010, and forecasted an attrition period of twelve months ending December 31, 2011.
[439] *Id.*
[440] *Id.*
[441] *Id.* at Exhibit MAM-10.

primarily due to a shift in functions from TAWC to AWWSC and increases in pension and group insurance costs related to financial market conditions, over which TAWC had little control.[442] In addition, an accounting change, in which the costs of capital assets now on the books of AWWSC were offset by the avoidance of those costs on the books of TAWC, contributed significantly to the increase.[443]

The Company filed testimony asserting that, from 2005 until the 2011 attrition year, ratepayers have saved $1.229 million because of the realignment and shifting of services from TAWC to AWWSC.[444] TAWC also asserted that customers benefitted from having (1) round-the-clock call center availability; (2) convenient automated Interactive Voice Response (IVR) contact with the call center; (3) on-line access to TAWC service personnel, which permits the scheduling of service orders at convenient times for the customers; and (4) improved efficiencies in the tracking of service orders and service employees.[445] Citing certain findings that were noted in section IV of the Schumaker Audit Report, the Company further maintained that the Schumaker Audit Report confirmed that the shifting of functions from TAWC to AWWSC had resulted in savings and service improvements to the benefit of TAWC's customers.[446]

Through its witness, Mr. Terry Buckner, the CAPD forecasted $3,653,946 in management fees for the attrition period.[447] In its calculations, the CAPD started with $3,529,933 as its base amount, which had been the management fees amount approved previously in Docket No. 08-00039, then increased this amount by the annual customer growth and GDP rate of 0.54% in 2009; 1.70% in 2010; and 1.60% for 2011.[448] The CAPD asserted that

[442] *Id.* at 46.
[443] *Id.*
[444] *Id.*
[445] *Id.*
[446] *Id.* at 47.
[447] Terry Buckner, Second Amendment to Direct Testimony, Amended Exhibit 1, Schedule 5 (Hearing Exhibit 90) (March 8, 2011).
[448] Terry Buckner, Non-Confidential Direct Testimony Amendment, p. 28 (January 31, 2011).

its calculation was consistent with the methodology adopted by the TRA in Docket No. 08-00039.[449]

Further, the CAPD asserted that TAWC's calculation of management fees was not just and reasonable because it included costs unnecessary for the provision of water service, including: (1) an over-allocation of charges to TAWC primarily based on non-cost causative factors; (2) AIP compensation, which is primarily based on financial goals; (3) Stock Based Compensation Expense, also known as LTIP compensation; (4) Business Development expense, which is devoted to non-regulated operations; (5) External Affairs expense, which is devoted to marketing, advertising, lobbying, and political influence; (6) contained non-recurring accounting charges for changes in financial reporting to the IRS; (7) double counted and overestimated payroll increases; (8) failed to comport with current economic conditions; and (9) included non-normalized salaries.[450]

Through its witness, Ms. Dismukes, the City recommended that three adjustments be applied to management fees. Ms. Dismukes testified that the study conducted by Mr. Baryenbruch, TAWC's witness, contained numerous flaws and failed to demonstrate that AWWSC's charges are necessary, just or reasonable. Ms. Dismukes asserted that just as the operations of electric and gas utilities are very different from water companies, likewise the expenses of electric and gas utilities are dissimilar and, therefore, not comparable to the service company charges of water companies.[451] She contended that Mr. Baryenbruch failed to provide evidence to support his comparative analysis of the service company charges of electric and gas utilities to the charges of AWWSC as appropriate or reliable.[452] Ms. Dismukes recommended a comparison of the AWWSC's charges with that of other water and combination

[449] *Id.*
[450] *Id.* at 29-30.
[451] Kimberly H. Dismukes, Pre-Filed Direct Testimony, pp. 4, 27-33 (January 5, 2011).
[452] *Id.* at 33-39.

water/wastewater utilities, and that the water company comparative analysis she had performed showed that the AWWSC charges were excessive.[453] As a result, Ms. Dismukes recommended that test year management fees be reduced by $4,089,360 in order to reflect a lower cost consistent with the costs incurred by comparable Class A water and combination water/wastewater companies.[454]

For these same reasons, Ms. Dismukes challenged Mr. Baryenbruch's comparison and findings concerning TAWC's customer service costs.[455] She asserted that the inherent differences that exist between water companies and electric and gas utilities would indicate that customer service costs should be less for water companies.[456] In keeping with her comparative approach and analysis using water companies, Ms. Dismukes recommended an additional reduction of $464,661 to expenses for excessive customer costs charged to the Company by AWWSC.[457] In addition, Ms. Dismukes asserted that the analysis employed in Schumaker Audit Report as to the reasonableness of the AWWSC charges in 2008, which compared the service charges of electric and electric/gas companies with AWWSC, an approach similar to that utilized by Mr. Baryenbruch, was similarly flawed and inappropriate and should be rejected by the TRA.[458] Ms. Dismukes further asserted that the analysis contained within the Baryenbruch study did not reliably support a finding that AWWSC's services were provided at the lower of cost or market, nor that the level of services provided by the service company would be required if TAWC were a stand-alone water company.[459]

Finally, Ms. Dismukes recommended the removal of a combined $94,658 for two categories of expenses, which she asserts the Company improperly included: business

[453] *Id.* at 27-33.
[454] *Id.* at 43.
[455] *Id.* at 43-45.
[456] *Id.* at 4, 43-44.
[457] *Id.* at 4, 44-45; and *see* Transcript of Proceedings, Vol. II C, Hearing Exhibit 35 (March 1, 2011) (Ms. Dismukes revised her recommendation that customer account expenses be reduced from $676,655 to $464,661).
[458] *Id.* at 45-46.
[459] *Id.* at 46-49.

development and corporate government affairs.[460] Business development expenses consist of expenses that the Company claims were incurred for the purpose of growing revenue and customer base.[461] Ms. Dismukes testified that, although TAWC failed to quantify the benefits that customers received from its business development efforts, she had examined the expenses incurred for business development activities at both the regional and national levels and found that the costs incurred by TAWC for business development have not resulted in significant enhancements in customer growth for the Company.[462] Further, Ms. Dismukes contended that TAWC had failed to demonstrate that the business development expenses charged to it by AWWSC are just and reasonable, cost effective, or necessary for the provision of safe and reliable service.[463] Further, Ms. Dismukes asserted that both the Florida and California state regulatory commissions have disallowed expenses related to business development and acquisitions.[464] Therefore, she recommended that $82,861 in business development expenses should be removed from the expenses allocated for the attrition year.[465]

Ms. Dismukes further recommended that expenses related to legislative functions and advocacy performed by service company personnel in the Corporate Government Affairs unit should not be passed on to ratepayers. She asserted that regulators often disallow these types of expenses, and noted that both the Florida and California state commissions do not allow utilities to recover expenses of this type from ratepayers.[466] Ms. Dismukes recommended that the $11,797 charged for legislative functions of corporate government affairs be removed from expenses allocated for the attrition year.[467]

Michael Gorman, witness for CRMA, asserted that no witness for the Company has

[460] *Id.* at 5, 49-55.
[461] *Id.* at 50.
[462] *Id.* at 51-52.
[463] *Id.* at 52.
[464] *Id.* at 53-54.
[465] *Id.* at 53.
[466] *Id.* at 54.
[467] *Id.* at 54.

provided sufficient evidence to the support the substantial increase requested in the rate petition and, therefore, the increase is not known and measurable and should be rejected.[468]

Findings and Conclusions

Previously, in Docket No. 08-00039, the TRA determined management fees using the amount forecasted by the Company for its 2005 management fees, as originally filed in Docket No. 04-00288, and applied a growth factor.[469] Based on this methodology, in this case the CAPD utilized the management fees amount that was most recently ordered by the Authority in Docket No. 08-00039 as its base, then applied its recommended growth factor.[470] The Authority disagrees with the CAPD's contention that the methodology used by the TRA to forecast management fees in Docket No. 08-00039 established precedent in this Docket. The method utilized by the Authority to forecast management fees in Docket No. 08-00039 was necessary as a result of the lack of sufficient evidence in the record to support TAWC's forecasted management fees, due in large part to the Company's failure to file a management audit that complied with the requirements ordered by the Authority. Nevertheless, the TRA is not bound to a previously employed methodology when determining the allocations appropriate in future cases. This is particularly true when better, more recent or accurate evidence is presented by the parties or otherwise made part of the record, which would allow the TRA to more accurately forecast future results.

In Docket No. 08-00039, the TRA ordered a comprehensive management audit be conducted by an independent certified public accountant for the primary purposes of investigating the management performance and decisions relating to internal processes and controls of AWWSC and to evaluate that the allocation methodology, factors, and resulting costs

[468] Michael Gorman, Pre-filed Direct Testimony, p. 23 (January 5, 2011).
[469] *See In re: Petition of Tennessee American Water Company to Change and Increase Certain Rates and Charges so as to Permit It to Earn a Fair and Adequate Rate of Return on Its Property Used and Useful in Furnishing Water Service to Its Customers,* Docket No. 08-00039, *Order,* p. 21 (January 13, 2009).
[470] Terry Buckner, Non-Confidential Direct Testimony Amendment, p. 28 (January 31, 2011).

for services charged to TAWC were efficient, accurate, and reasonable.[471] To that end, the Authority initiated the proceedings in Docket No. 09-00086, and wherein, upon completion, was filed the Schumaker Audit Report.[472] In the instant case, both the CAPD and City offered testimony concerning the Schumaker Audit Report, its processes and results. Yet, while the CAPD noted certain concerns about the reliability of the audit, it does not completely reject the methodology utilized or credentials of the auditor.[473] Rather, the CAPD's testimony focuses more on other, alternative methodologies that might have been utilized instead but does not critically analyze the methods and processes employed by Schumaker & Company in its preparation of the Schumaker Audit Report.[474]

In its recent opinion, the Court of Appeals held that the TRA's decision to use the 2005 management fees to forecast fees in Docket No. 08-00039 was a "reasonable, temporary, solution to the dilemma faced [by the TRA] until TAWC could submit a proper management audit."[475] Here, the Authority acknowledges that a new management audit has been performed by Schumaker & Company in compliance with the requirements of the RFP, and that the findings set forth in detail in the Schumaker Audit Report state that the management fees and cost allocations charged to TAWC are reasonable and prudent. Even the City's witness, Ms. Dismukes, agreed that the use of customers to allocate costs to TAWC was acceptable, even though in her opinion other, more superior approaches could have been utilized.[476]

Further, despite the panel's agreement that Mr. Baryenbruch's study cannot be relied

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[471] *See In re: Petition of Tennessee American Water Company to Change and Increase Certain Rates and Charges so as to Permit It to Earn a Fair and Adequate Rate of Return on Its Property Used and Useful in Furnishing Water Service to Its Customers,* Docket No. 08-00039, *Order,* pp. 21-22 (January 13, 2009).

[472] *See In re: Tennessee American Water Company's Request for Proposal for a Management Audit,* Docket No. 09-00086, *Notice of Filing of Confidential and Proprietary Portions of Workpapers Related to Schumaker & Company's Affiliate Audit Report of Tennessee American Water Company for the Tennessee Regulatory Authority* (September 27, 2010).

[473] Terry Buckner, Non-Confidential Direct Testimony Amendment, pp. 23-25 (January 31, 2011).

[474] *Id.*

[475] *See Tennessee American Water Co. v. Tenn. Regulatory Auth.,* 2011 WL 334678, at *20 (Tenn. Ct. App. Jan. 28, 2011).

[476] Kimberly H. Dismukes, Pre-Filed Direct Testimony, pp. 3, 18-20 (January 5, 2011).

upon to conclude that AWWSC provides services at less than the prevailing market rate, the Authority disagrees with the City's contention that $4,089,360 of expenses in service costs should be eliminated from management fees. While the Authority agrees that there were flaws in Mr. Baryenbruch's study, especially as to the billed rates and number of hours billed to professionals, it cannot agree with the City's assertion that Mr. Baryenbruch's study, however flawed, thereby leads to the conclusion that there is no evidentiary basis upon which to allow recovery of a majority of the management fees requested by TAWC.

Therefore, upon consideration of the record, the Authority allocates recovery of $4,741,068 in management fees for the attrition period. It determines this amount based on the Company's normalized amount of management fees of $5,048,200[477] for the twelve months ended September 30, 2010,[478] then eliminates $172,295 for External Affairs expense, $89,720 for Business Development, 50% ($89,734) of the AIP, and adjusts the residual amount by an annual inflation rate of .76% compounded for fifteen months (or .95%).

In its elimination of expenses related to corporate government affairs, the Authority determines that because lobbying expenses are not necessary to the provision of safe and reliable water service, such expenses are appropriately disallowed for rate making purposes. Further, because the Authority concludes that it is not reasonable to allow recovery of an expense that does not enhance customer growth, business development expenses in the amount of $89,720 are eliminated from our calculations. The Authority agrees with TAWC's assertion that both the Company and its customers benefit from AIP through higher financial returns for the Company. For this reason, the Authority therefore approves recovery of one-half of the AIP and correspondingly eliminates 50% ($89,734) of AIP. The elimination of 50% of AIP is consistent

[477] TAWC's December 8th Supplemental Responses To The First Discovery Request And Supplemental Discovery Request Of The CAPD, Question 102, TN-CAPD-SUPPLEMENTAL2-Q102-ATTACHMENT 2 (December 8, 2010).

[478] As noted previously in this *Final Order*, the twelve months ending September 30, 2010 is consistent with the test period recommended and utilized by the CAPD.

with the Authority's removal of 50% of AIP from employee benefits.

Following the aforementioned adjustments to management fees, the panel applies an inflation factor of .95%[479] in order to calculate management fees for the attrition period. The panel utilizes an annual GDP Chained Price Deflator growth rate of .76% as of September 2010, divides this rate by twelve months, then multiplies by fifteen months to arrive at the December 2011 growth rate. The result of these calculations is $4,741,068 for allocation to management fees in this case.

V(B)7. GROUP INSURANCE

The Company projected total Group Insurance Expense of $2,034,757.[480] This category included Group Insurance and Other Post Employment Benefits ("OPEB"). The Company forecasted Group Insurance expenses of $1,075,184.[481] This amount was calculated by applying March 31, 2010 insurance rates to 109[482] anticipated employees. The Company forecasted OPEB of $959,573 for the attrition period.[483] The Company's actuary, Towers/Watson, provided a letter which projects $1,140,000 for the total OPEBs. [484] The Company applied a 15.83% capitalization rate to the OPEBs to remove the capitalized portion of OPEBS from O&M Expense.

Subsequently, the Company adjusted its projection of Group Insurance Expense from $2,034,757 to $2,220,281 for the attrition period.[485] The Company updated the Group Insurance

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[479] The mathematic calculation is demonstrated as follows: $5,048,200 - $172,295 - $89,720 - $87,734 = $4,696,451 (This number represents the balance of management fee calculation after the noted reductions, but before application of the growth factor).
[480] *Petition*, Exhibit No. 2, Schedule 3 (September 23, 2010).
[481] *Petition*, Exhibit No. 1, Schedule 3, p. 3 of 6 (September 23, 2010).
[482] There are 110 forecasted employees as stated above in the discussion of Salaries and Wages. One employee, however, opted out of the Group Insurance plan.
[483] *Petition*, Exhibit No. 1, Schedule 3, p. 3 of 6 (September 23, 2010).
[484] TAWC's Responses To The TRA's Second Data Requests Dated October 26, 2010, TN-TRA-02-Q92d-Attachment, p. 9 of 28 (December 1, 2010).
[485] TAWC's Responses To The TRA's Second Data Requests Dated October 26, 2010, TN-TRA-02-Q121-Attachment 2 (December 1, 2010).

portion to $1,260,708 to reflect October 1, 2010 insurance rates.[486] In rebuttal testimony, the Company further revised Group Insurance to $2,434,923 for the attrition period.[487] The Company then applied a capitalization factor of 15.83% to remove the capitalized portion from O&M Expenses.

The CAPD originally forecasted attrition period Group Insurance Expense of $2,166,396.[488] Subsequently, the CAPD adjusted its growth factor and changed the projection of Group Insurance Expense to $2,165,261,[489] including Group Insurance of $1,118,530 and OPEBs of $1,046,730.[490] Group Insurance of $1,118,530 was priced out based on October 1, 2010 insurance rates and 104 Employees.[491] The CAPD used the actual book value listed in TAWC's Income Statements for its test period of the twelve months ended September 30, 2010 as a starting point for OPEBs and then increased its estimate of OPEBS by its inflation factor plus one-half of the customer growth. [492] The CAPD filed amended testimony on March 1, 2011 in which it changed the residential customer growth factor utilized to project revenues from 0.89% to 1.05%,[493] and this caused the CAPD's growth/inflation factor to change from 1.40% to 1.48%.[494] The effect of this adjustment was to increase the CAPD's figure for Group Insurance Expense from $2,165,261 to $2,166,035.[495]

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[486] *Id.*
[487] TAWC's February 22nd Supplemental Revised Accounting Exhibits and Workpapers, Revised Exhibit No. 2, Schedule 3 (February 22, 2011).
[488] Terry Buckner, Pre-Filed Direct Testimony, Exhibit 1, Schedule 5, p. 5 of 9 (January 5, 2011).
[489] Terry Buckner, Non-Confidential Direct Testimony Amendment, Amended Exhibit 1, Schedule 5, p. 5 of 9 (January 31, 2011).
[490] Terry Buckner, Non-Confidential Direct Testimony Amendment, Workpaper AMENDED E-GI (January 31, 2011).
[491] Terry Buckner, Pre-Filed Direct Testimony, Workpaper E-GIA (January 5, 2011).
[492] Terry Buckner, Non-Confidential Direct Testimony Amendment, Workpaper AMENDED E-GI (January 31, 2011).
[493] John Hughes, Amendment to Amended Testimony filed February 25, 2011, Workpaper R-CUSTOMER GROWTH (March 1, 2011).
[494] Terry Buckner, Second Amendment to Direct Testimony, Workpaper AMENDED E-GI (Hearing Exhibit 90) (March 8, 2011).
[495] *Id.*

The TRA adopts an attrition period forecast of $2,111,420 for Group Insurance Expense, after removing the capitalized amount using a 20.57% capitalization percentage, again consistent with the panel's treatment of Salaries and Wages Expenses. This forecast consisted of $1,189,740 related to Group Insurance costs and $921,680 related to OPEBs. This amount was calculated by using the 109 employees (out of the 110 anticipated employees) enrolling in the plan and the October 1, 2010 insurance rates to price out the Group Insurance and then applying the CAPD's capitalization percentage of 20.57% consistent with Salaries and Wages Expense. The OPEB amount for the attrition period was based on contribution under the funding policy amount of $38,678,936 for AWWSC from the latest actuarial report. This amount was allocated from the service company to TAWC at 3%. The capitalized amount of TAWC's portion was then revised, using the CAPD's 20.57% capitalization percentage, again consistent with the treatment of Salaries and Wages Expenses.

V(B)8. PENSION EXPENSE

The Company initially forecasted Pension Expense of $1,645,113 for the attrition period.[496] This amount was taken from a letter written by the Company's actuary, instead of the annual actuarial report that has been used in past cases, which stated that the minimum ERISA contribution for the service company would be $109.8 million for 2011.[497] Based on this, the amount to be allocated to TAWC would be 1.78% or $1,954,440.[498] The Company then applied its capitalization factor of 15.83% to eliminate the capitalized portion from O&M Expenses to reach its initial forecast.[499] Subsequently, the Company revised Pension Expense from $1,645,113 to $2,062,140. The revision was a result of a quarterly update from the actuary to the Company, which updated the forecast of minimum pension contributions for the service

[496] *Petition*, Exhibit No.2, Schedule 3, p. 3 of 6 (September 23, 2010).
[497] TAWC's Responses to the TRA's Data Requests Dated September 20, 2010, TN-TRA-01-Q013-Labor, p. 12 (September 24, 2010).
[498] *Id.*
[499] Sheila A. Miller, Pre-Filed Direct Testimony, p. 7 (September 23, 2010).

company to $137.6 million. The Company revised Pension Expense and allocated TAWC's portion (1.78% of the minimum ERISA contribution, or $2,449,880) then reduced that amount by the Company's capitalization percentage of 15.83%.[500]

The CAPD forecasted $1,552,412 attrition period Pension Expense.[501] The CAPD adopted $1,954,440, which was the 1.78% Tennessee portion of the original pension funding amount calculated by the Company and then applied its capitalization percentage of 20.57% to eliminate the capitalized portion from O&M Expenses.[502] The CAPD stated that the quarterly update from the actuary, which the Company relied upon, had a footnote stating that $37 million is "[s]ubject to change pending the results of the July 1, 2011 valuation, which will be known in late August."[503] The CAPD stated that it is reluctant to set rates on a pension contribution which is not known by the actuary and is subject to change.[504]

The Authority adopts an attrition period forecast of $839,965 for Pension Expense. The Authority has historically included in rates the minimum required contribution as recommended in the latest actuarial report, rather than a preliminary estimate in a letter from the actuary. The actuarial report submitted by the Company recommended a minimum contribution of $59,409,620 as of July 1, 2009.[505] The Authority adopted Pension Expense for TAWC based on an allocation factor of 1.78% applied to recommended minimum contributions set forth in the latest actuary report. The Company's portion of ERISA minimum pension contribution was multiplied by the CAPD's capitalization percentage of 20.57% to arrive at attrition period Pension Expense of $839,965.

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[500] TAWC's December 17th Supplemental Responses To The CAPD's Discovery Requests, TN-CAPD-01-PART III-Q48-Supplemental Confidential Attachment 3 (December 17, 2010).
[501] Terry Buckner, Pre-Filed Direct Testimony, Workpaper E-PENSION (January 5, 2011).
[502] *Id.*
[503] Terry Buckner, Pre-Filed Direct Testimony, pp. 41-42 (January 5, 2011).
[504] *Id.* at 42.
[505] TAWC's Responses to the TRA's Data Requests Dated September 20, 2010, TRA-01-Q36-ATTACHMENT, pp. 55, 60 (Actuarial Report April 2010) (September 24, 2010).

V(B)9. REGULATORY EXPENSE

The Company projected $379,918 in Regulatory Expense for the attrition period. This amount represents the total of the amortization of various rate case expenses sought by the Company and included in this case. The Company stated in its testimony that it was seeking the following:

1. Estimated cost of this case ($645,000) amortized over 3 years;
2. Estimated cost of service study for this case ($42,500) amortized over 3 years; and
3. 12 months of amortization of 2006 rate case, 2008 rate case, 2008 cost of service, and the 2008 depreciation study totaling $150,751.[506]

In rebuttal testimony, the Company projected $847,368 in Regulatory Expense for the attrition period, which is $467,450 higher than stated in the *Petition*.[507] Part of the difference related to the Tennessee Court of Appeals' decision reversing the Authority's disallowance of $275,000 in rate case expense from Docket No. 08-00039.[508] The Company proposed to include that rate case expense, which the Company had absorbed since September 2008, in the attrition year. The Company also increased the expected cost of this case from the $645,000 estimated in the *Petition* to a total of $1,240,492.[509] The Company updated the current rate case expense by (1) including the actual costs incurred to date as of January 31, 2011, (2) adding the estimated additional legal costs for the witnesses' rebuttal testimony, which included two new witnesses whose testimony was not originally anticipated, and (3) adding the estimated costs associated with conducting a full evidentiary hearing in Chattanooga.[510] The Company stated that these costs were reasonable based on the volume of discovery requests propounded by the Intervenors, the number of issues raised and addressed by the Intervenors in the testimony they presented, the

[506] Sheila A. Miller, Pre-Filed Direct Testimony, pp. 12-13 (September 23, 2010).
[507] TAWC's Revised Accounting Exhibits and Workpapers, Revised Exhibit No. 2, Schedule 3 (February 14, 2011).
[508] Michael A. Miller, Pre-Filed Rebuttal Testimony, p. 78 (February 8, 2011).
[509] *Id.*
[510] *Id.*

number of discovery disputes, the increased number of Intervenors, and the cost of moving the evidentiary hearing to Chattanooga.[511]

The CAPD projected Regulatory Expense for the attrition period of $195,284.[512] The CAPD stated in its testimony that its calculation of Regulatory Expense included the following:

1. Amortization for the cost of service studies performed in Docket No. 06-00290 at $8,004 per year and in Docket No. 08-00039 at $3,204 per year;
2. Amortization of the depreciation study in Docket No. 08-00039 amounting to $7,826 per year;
3. Amortization of rate case costs associated with Docket No. 08-00039 at $68,750; and
4. Estimated cost of this case ($322,500) amortized over three years at $107,500 for the attrition period.[513]

The CAPD did not include amounts for the cost of service study performed in the current docket. The CAPD eliminated this cost from its calculation of Regulatory Expenses asserting that (1) it is unacceptable to use "judgment factors" for a cost of service study because it would result in a cost of service study that cannot be independently verified or corroborated, and (2) the results of the cost of service study were not used by the Company in setting the proposed rates.[514] On March 8, 2011, the CAPD provided revised exhibits projecting Regulatory Expenses of $298,884, which included the following:

1. Amortization for the cost of service studies performed in Docket No. 06-00290 at $8,004 per year and in Docket No. 08-00039 at $3,204 per year;
2. Amortization of the depreciation study expense in Docket No. 08-00039, amounting to $7,826 per year;
3. Amortization of rate case costs associated with Docket No. 06-00290 ($44,433);
4. Amortization of rate case costs associated with Docket No. 08-00039 ($68,750); and
5. Amortization of the estimated cost of this case ($500,000) over three years at $166,667 for the attrition period.[515]

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[511] *Id.*
[512] Terry Buckner, Pre-Filed Direct Testimony, Exhibit 1, Schedule 5, p. 5 of 9 (January 5, 2011).
[513] *Id.* at 41-43 (January 5, 2011).
[514] William H. Novak, Pre-Filed Direct Testimony, p. 6 (January 5, 2011).
[515] Terry Buckner, Second Amendment to Direct Testimony, Workpaper AMENDED E-REG (Hearing Exhibit 90) (March 8, 2011).

On March 8, 2011, prior to the close of the Hearing, the City motioned to exclude from the record certain exhibits consisting of revised schedules and rebuttal testimony filed or offered by TAWC that purported to increase TAWC's revenue requirement from the $9.9 million originally petitioned to approximately $11.5 million, of which a portion reflected an increase in rate case expense from $645,000 to $1.2 million, which TAWC asserted was properly considered by the Authority in setting rates.[516] Despite denial of the motion by Chairman Freeman, TAWC offered additional explanation of its position as to the appropriate use of the revenue information by the TRA.[517] The City objected, and reasserted its position that that such evidence should not be included or considered in the record.[518]

Following the arguments of the parties, Director Roberson stated that over the years he had seen a significant and dramatic increase in the amount requested for rate case expenses and voiced his concern that in this case, the testimony, exhibits, and responses to data requests failed to provide a sufficient evidentiary record upon which the TRA could base a decision on the issue of rate case expense requested by the Company.[519] Citing the Court of Appeals recent Opinion in which it reversed the TRA's decision to cut in half the rate case expenses allowed in Docket No. 08-00039, finding that such decision was arbitrary due to a lack of specific evidence in the record and Final Order, Director Roberson moved that the Company provide detailed evidence of its rate case expenses, including itemized bills from experts, attorneys, and Company witnesses, to demonstrate that the rate case expenses being claimed are necessary, reasonable, and prudent.[520] Director Roberson further moved to direct the Company to file this evidence through

[516] Transcript of Proceedings, Vol. VII B, pp. 114-115 and pp. 119-128 (March 8, 2011) (concerning City's "third item" for discussion).
[517] *Id.* at 119-121, 123-124.
[518] *Id.* at 121-123.
[519] *Id.* at 124-125, 127.
[520] *Id.* at 125-126 (citing *Tennessee American Water Co. v. TRA,* 2011 WL 334678 *27 (January 28, 2011) (holding that the record and Final Order did not explain which specific expenses the TRA deemed unnecessary, improvident, or improper, or that the Authority closely examined the costs associated with the rate case to determine the portion

affidavits or supplemental testimony, which was to be accompanied by bills, invoices, or other supporting documentation, and to grant the Intervenors an opportunity to respond through affidavits, live testimony, or supporting documentation, if necessary, so that the TRA would have a complete record on rate case expenses on the basis of which the Authority would closely examine the costs associated with this rate case.[521] Finally, Director Roberson moved that the Authority hear limited testimony with the appropriate cross-examination of witnesses in an expedited hearing to be held on March 28, 2011 exclusively on the issue of rate case expense.[522] The motion was approved unanimously by the panel.

On March 16, 2011, the parties filed a *Joint Motion for Approval of Rate Case Expenses* in which the parties agreed to limit the amount of rate case expenses approved in this docket to $645,000, as filed in the Company's original *Petition.* All of the parties in this docket asked that the Authority approve the agreed amount as the final rate case expenses to be recovered by TAWC without the necessity of further proof and in lieu of a separate proceeding on the issue. The parties' agreement reflected an effort to expedite the completion of the case and, thereby, avoid the possibility of TAWC implementing the full amount of its rate request under bond prior to April 5, 2011.[523] On March 22, 2011, the Hearing Officer entered an Initial Order[524] that found that the filing of the *Joint Motion* acted as a stipulation of the parties as to the issue of the rate case expense to be recovered in this case and concluded that no further proceedings, including the filing of testimony or convening of a hearing for the purpose of cross-examination

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to be recovered by rate payers, and further admonishing that such examination should have taken place and its results included in the record and Final Order).

[521] *Id.* at 126-127.

[522] *Id.*

[523] The Company would have been entitled to implement under bond the full amount of the requested rate increase under Tenn. Code Ann. § 65-5-103 (2004) in the event that the TRA did not render a final decision within six months of the Company's filing of its *Petition.*

[524] *Initial Order of Hearing Officer Relating to Proof on Rate Case Expenses and the Joint Motion Filed by the Parties*, pp. 5-6 (March 22, 2011).

of evidence, were necessary.[525] Furthermore, the decision to accept the amount proposed was within the purview of the voting panel assigned in this docket, and in light of this development, convening a separate proceeding on the issue of rate case expense at this time imposed an additional and unnecessary expense on the parties and, possibly, on the ratepayers of TAWC.[526]

During the hearing, the panel adopted an attrition period forecast of $277,880 for regulatory expenses. This included:

1. Amortization of attrition year unamortized balance of rate case costs associated with Docket No. 08-00039 of $146,139 for an annual cost of $48,713;
2. Cost of this case ($645,000) amortized over three years starting in April for an annual cost of $215,000; and
3. Estimated cost of service study for this case ($42,500) amortized over three years for an annual cost of $14,167.

In addition, this matter came before the panel during the regularly scheduled Authority Conference held on August 22, 2011, for consideration of the method by which recovery of $275,000 in regulatory fees due the Company following reversal of the TRA's decision in Docket No. 08-00039 by the Court of Appeals.[527] A majority of the panel voted to allow recovery of the $275,000 regulatory expense through a separate line item charge on customer bills, which will discontinue once the full amount has been recovered.[528] The Company was directed to file tariffs to include the surcharge, including all supporting calculations, within ten days and to work with the TRA Staff on the acceptable line item language for inclusion in customers' bills.[529]

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[525] *Id.*
[526] *Id.*
[527] The Court of Appeals issued its mandate in that appeal on June 7, 2011.
[528] Director Kyle moved to allow TAWC to recover the $275,000 through a temporary increase in fixed monthly service charges and usage rates, as proposed by the Company, which would reduce to current levels when the Company had collected the $275,000 in full, and directed that the Company file all documentation for the new rates and work with David Foster, Chief, and Pat Murphy, Deputy Chief, of the TRA's Utilities Division. This motion failed for lack of a second.
[529] Transcript of Proceedings, p. 79 (August 22, 2011).

The Authority adopts $397,217 for FICA Tax for the attrition period because this forecast is consistent with the price-out calculation for Salaries and Wages Expense for 110 employees and applies a capitalization percentage of 20.57%.

V(C)6. UNEMPLOYMENT TAX

The Company projected Unemployment Tax of $17,685.[614] The Company forecasted its attrition period Unemployment Tax by multiplying 110 employees by the appropriate tax base, and applying the current tax rate. The Company then applied a capitalization percentage of 15.83%.

The CAPD projected Unemployment Tax of $15,778.[615] The CAPD performed empirical calculations on a forecasted average of 104 Tennessee employees for the test period ended September 2010. The CAPD multiplied 104 employees by the appropriate tax base and current tax rate, and applied a capitalization percentage of 20.57%.[616]

The Authority adopts $16,688 for Unemployment Tax for the attrition period. This forecast is consistent with the forecast of Salaries and Wages Expense for 110 employees and a capitalization percentage of 20.57%.

V(C)7. STATE EXCISE TAX

The Authority adopts an Excise Tax amount of $223,534 for the attrition period. This amount is calculated using forecasted results from operations at current rates for the attrition period, and adjusted for interest expense, permanent differences, and applies the statutory tax rate of 6.5%. Additionally, the state excise tax was included on the amount of the projected revenue deficiency.

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[614] *Petition*, Exhibit No. 2, Schedule 5 (September 23, 2011).
[615] Terry Buckner, Second Amendment to Direct Testimony, Amended Exhibit 1, Schedule 6, p. 6 of 9 (Hearing Exhibit 90) (March 8, 2011).
[616] Terry Buckner, Pre-Filed Direct Testimony, Workpaper E-PAY-4A, p.7 (January 5, 2011).

V(D). NET OPERATING INCOME

Based on the foregoing determinations, the Authority finds that TAWC's Net Operating Income is $5,937,860 for the attrition period prior to the application of taxes for additional attrition period revenues.

V(E). RATE BASE

Rate base is the total of the investor funded or supplied plant, facilities, and other investments used by the utility in providing service to its customers. Rate base is the investment base to which a fair rate of return is applied in order to determine the Company's net operating income requirement. Relying on its revised accounting exhibits, TAWC proposed a rate base amount of $120,967,931.[619] In its *Petition*, the Company stated that it used a test period ending March 31, 2010, made normalizing adjustments, and then projected the results to determine an attrition year of the twelve months ended December 31, 2011.[620] The Consumer Advocate asserted that the Authority should approve an attrition year rate base of $115,042,041.[621] For the reasons set forth below, the Authority adopts a rate base of $118,459,808 for the attrition year ended December 31, 2011.

V(E)1. UTILITY PLANT IN SERVICE ("UPIS")

In direct testimony, the Company projected an average attrition period balance for Utility Plant in Service ("UPIS") of $226,384,490.[622] TAWC President, Mr. Watson, testified that the projected UPIS will be used and useful and attributed the majority of the increase to two major projects. The first project is an upgrade of the Citico Treatment Plant that the Company states is necessary due to the Tennessee Department of Environment and Conservation's findings

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[619] TAWC's February 22nd Supplemental Revised Accounting Exhibits and Workpapers, Revised Exhibit No. 1, Schedule 1 (February 22, 2011).
[620] *Petition*, p. 4 (September 23, 2010).
[621] Terry Buckner, Second Amendment to Direct Testimony, Amended Exhibit 1, Schedule 1, p. 1 of 9 (Hearing Exhibit 90) (March 8, 2011).
[622] TAWC's February 22nd Supplemental Revised Accounting Exhibits and Workpapers, Revised Exhibit No. 1, Schedule 2, p. 1 of 3 (February 22, 2011).

regarding the need for a chemical off-loading facility. The second project consists of the replacement of one eight-inch steel water main and one twelve-inch water main in the Lookout Mountain service area. The total cost for both projects is $8.3 million.[623]

To calculate its UPIS, TAWC used account balances as of March 31, 2010 and included projected net additions and retirements. The Company then utilized its projected monthly account balances for the period December 1, 2010 through December 31, 2011 to calculate a thirteen-month average and forecast an attrition year balance of $226,384,490.[624]

The CAPD's calculation used test year balances as of September 30, 2010 and then applied the forecasted additions and retirements provided by TAWC in order to determine monthly amounts for plant in service through the attrition period ended December 31, 2011. The CAPD also used a thirteen-month average to arrive at a projected amount of $225,496,165.[625]

Although TAWC is correct in its assertion that the use of an alternative test year, such as proposed by an Intervenor, requires more work on the part of the utility in providing more recent financial information, the Authority disagrees that differing test years, after application of the proper adjustments, would result in "essentially the same"[626] attrition year amounts. In order for these amounts to be the same, all projections would have to be almost identical to the actual recorded amount, which is highly unlikely to occur for every account. The panel agrees with the CAPD that the use of more recent information often provides results that are a more accurate representation of what can be expected to occur on a going-forward basis.

For these reasons, the TRA finds that the later test period and normalizing adjustments made by the CAPD are likely to be more representative of future amounts for UPIS. Therefore,

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[623] John S. Watson, Pre-Filed Direct Testimony, pp. 5-6 (September 23, 2010).
[624] Sheila A. Miller, Pre-Filed Direct Testimony, pp. 19-20 (September 23, 2010).
[625] Terry Buckner, Non-Confidential Direct Testimony Amendment, p. 50 (January 31, 2011).
[626] Michael A. Miller, Pre-Filed Direct Testimony, p. 18 (September 23, 2010).

the panel adopts UPIS in the amount of $225,496,165 for the attrition period ending December 31, 2011.[627]

V(E)2. Construction Work In Progress

TAWC initially reported CWIP as $4,201,421, but later filed amended exhibits that decreased its CWIP amount by $1,165,021 to account for certain retirements.[628] Additional adjustments were made to CWIP expenditures in the amount of $1,545,192 in order to reflect an accurate amount actually spent during the annual period.[629] TAWC asserts that the CAPD did not appropriately consider the timing of the Company's capital spending throughout the year. Specifically, the CAPD utilized a later test period ending September 30, 2010, but failed to adjust for capital expenditures that had not taken place by the end of December 2010.

TAWC made adjustments to increase the capital expenditure amounts for CWIP by the difference between what TAWC projected would be spent by the end of December 2010 ($11,974,692) and the actual expenditures made by the end of December 2010 ($10,429,500) and spread the difference ($1,545,192) over the twelve months ended December 31, 2011.[630]

The CAPD forecasted CWIP in the amount of $2,681,318, using the later test period ending September 30, 2010.[631] In its post-hearing brief, the CAPD asserted that because of the interrelationship between CWIP and UPIS, capital spending projects should be accounted for in CWIP as they are being constructed and moved from CWIP to UPIS once the asset is placed into service.[632]

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[627] Director Roberson voted that the capital additions for the Citico treatment plant project of $5,301,305 be removed from rate case calculations, and that such an adjustment will reduce the overall revenue requirement by $753,736, including the reduced depreciation expense, accumulated depreciation, and the resulting tax effects (not including any adjustments to the accumulated deferred income taxes). He also stated that such projects will be allowed as it is implemented and a Hearing Officer will review and approve such requests by TAWC. Transcript of Proceedings, pp. 73-75 (April 4, 2011).

[628] Sheila A. Miller, Pre-Filed Rebuttal Testimony, p. 14 (February 8, 2011).

[629] *Id.*

[630] *Id.*

[631] Terry Buckner, Pre-Filed Direct Testimony, p. 50 (January 5, 2011).

[632] *Consumer Advocate and Protection Division's Post-Hearing Brief*, pp. 61-62 (March 21, 2011).

After all of the final exhibits and testimony had been filed, the parties' use of different test periods and treatment of capital projects, which the Company stated had not yet occurred as of the end of December 2010, revealed that the difference between the parties amounted to approximately $1.5 million. Upon review of the record, the TRA finds that TAWC did not provide any verifiable documentation to demonstrate that $1.5 million was not spent and, therefore, should be added to CWIP during the attrition period. Therefore, the panel agrees with the CAPD that moving the amounts from CWIP to UPIS is not necessary to prevent double counting for this projected amount.[633] Additionally, the Authority agrees that using a later test period as used by the CAPD is appropriate and adopts a CWIP balance of $2,681,318.

V(E)3. Utility Plant Capital Lease

The Company projected an average attrition period balance of $1,590,500 for Utility Plant Capital Lease. TAWC's booked amounts for the period ended March 31, 2010, were adjusted to reflect through the end of the attrition period and averaged for the thirteen months ending December 31, 2011.[634] As the known amount of annual leases does not fluctuate and would not be affected by using different test periods, no difference exists between the parties as to the calculation of Utility Plant Capital Lease. After reviewing the financial data, the TRA determines that Utility Plant Capital Lease for the attrition period is $1,590,500.

V(E)4. Working Capital

Working capital consists of the amount of funds needed to meet the Company's daily expenditures and a variety of non-plant investments. Working capital is necessary to sustain the ongoing operations of the utility until those expenditures can be recovered through revenues received from customers.

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[633] *Id.*

[634] Sheila A. Miller, Pre-Filed Direct Testimony, pp. 21-22 (September 23, 2010).

TAWC included Prepaid Taxes, Materials and Supplies, Deferred Regulatory Expense, Unamortized Debt Expense, Other Deferred Debits, Lead-Lag Study and Incidental Collections in Working Capital.[635] The following schedule shows the respective positions of the parties:

	TAWC[636]	CAPD[637]	Difference
Prepaid Taxes	284,235	414,322	(130,087)
Materials and Supplies	254,110	215,798	38,312
Deferred Regulatory Exp.	1,228,535	458,486	770,049
Unamortized Debt Exp.	460,845	460,842	3
Other Deferred Debits	280,983	280,997	(14)
Lead-Lag Study	987,000	640,976	346,024
Incidental Collections	(1,562,812)	(1,562,481)	(331)
Total Working Capital	1,932,896	908,940	1,023,955

TAWC projected Prepaid Taxes of $284,235 based upon a thirteen-month average balance for the test year ending March 31, 2010.[638] The CAPD projected Prepaid Taxes using a test period ended September 30, 2010 and a thirteen-month average, resulting in Prepaid Taxes of $414,322.[639]

TAWC projected Material and Supplies based upon a thirteen-month average balance for the test year ended March 31, 2010, which resulted in $254,110.[640] The CAPD projected Materials and Supplies of $215,798 using a test period ending September 30, 2010 and a thirteen-month average.[641]

In rebuttal testimony, TAWC increased its Deferred Regulatory Expense to $1,228,535[642] and asserted that this revised amount was a better projection and included the additional costs it anticipated incurring as a result of the Hearing having been located in Chattanooga. TAWC's

[635] Sheila A. Miller, Pre-Filed Direct Testimony, pp. 20-21 (September 23, 2010).
[636] TAWC's February 22nd Supplemental Revised Accounting Exhibits and Workpapers, Revised Exhibit No. 1, Schedule 3, p. 1 of 6 (February 22, 2011).
[637] Terry Buckner, Second Amendment to Direct Testimony, Workpaper AMENDED RB-WORKING CAPITAL REQUIREMENT (Hearing Exhibit 90) (March 8, 2011).
[638] TAWC's February 22nd Supplemental Revised Accounting Exhibits and Workpapers, Revised Exhibit No. 1, Schedule 3, p. 1 of 6 (February 22, 2011).
[639] Terry Buckner, Pre-Filed Direct Testimony, Workpaper RB-PREPAID TAXES, p. 99 (January 5, 2011).
[640] TAWC's February 22nd Supplemental Revised Accounting Exhibits and Workpapers, Revised Exhibit No. 1, Schedule 3, p. 1 of 6 (February 22, 2011).
[641] Terry Buckner, Pre-Filed Direct Testimony, Workpaper RB-M&S, p. 98 (January 5, 2011).
[642] TAWC's February 22nd Supplemental Revised Accounting Exhibits and Workpapers, Revised Exhibit No. 1, Schedule 3, p. 1 of 6 (February 22, 2011).

revised expense of $1,228,535 reflected a thirteen month average of unamortized balances as of December 31, 2011. To calculate this amount, TAWC used $1.2 million as the total cost for this rate case, and added $275,000 from its prior rate case (Docket No. 08-00039),[643] the unamortized balance of $23,773 for its cost of service study, and $3,010 for its depreciation study.[644]

In its amended schedules, Consumer Advocate projected $458,486 for Deferred Regulatory Expense. Nevertheless, the supporting schedule it filed consisted of $458,486 in Deferred Rate Case Expense, $3,009 for the Deferred Depreciation Study, and $12,533 for the Deferred Cost of Service Study, which totals $474,028.[645] The CAPD attributed the difference primarily to TAWC's having used $1.2 million as the rate case cost for this docket and adding the $275,000 rate case costs incurred in Docket No. 08-00039; whereas, the CAPD used the rate case costs approved by the Authority. The CAPD asserted that TAWC should not be allowed to include excessive rate case expenses that the TRA had not approved.[646] TAWC responded that rate cases benefit shareholders as well as utilities.[647]

As noted above, Director Roberson expressed concern during the Hearing regarding regulatory fees and moved to require additional information be filed to substantiate TAWC's request in this case.[648] Director Roberson further proposed that an expedited hearing be held on this matter, which was approved unanimously by the panel.[649] Subsequently, on March 16, 2011, the parties filed a Joint Motion for Approval of Rate Case Expense stipulating to the Company's recovery of $645,000 in rate case expense. This stipulated amount includes a total Deferred Regulatory Expense in the amount of $630,897, which consists of $589,165 for rate

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[643] Discussed supra; *see Tenn. Amer. Water Co. v. TRA*, 2011 WL 334678 (Tenn. Ct. App. Jan. 28, 2011).
[644] TAWC's Responses To The TRA's Fifth Data Request Dated Feb. 15, 2011, Question 170, TN-TRA-05-Q170-ATTACHMENT (February 22, 2011).
[645] Terry Buckner, Second Amendment to Direct Testimony, Workpaper AMENDED RB-DEFERRED REGULATORY (Hearing Exhibit 90) (March 8, 2011).
[646] Terry Buckner, Pre-Filed Direct Testimony, p. 51 (January 5, 2011).
[647] Michael A. Miller, Pre-Filed Rebuttal Testimony, pp. 76-79 (February 8, 2011).
[648] Transcript of Proceedings, Vol. VII B, pp. 126-127 (March 8, 2011).
[649] *Id.* at 127.

case expense, $38,723 for the cost of service study expense, and $3,010 for depreciation study expense.

TAWC projected its Unamortized Debt Expense based upon an account balance as of March 31, 2010, adding its new debt, and subtracting cumulative amortizations to arrive at monthly amounts for a thirteen-month average.[650] The CAPD used the same methodology as the Company with a starting account balance as of September 30, 2010.[651]

TAWC projected its Other Deferred Debits using a thirteen-month average of the unamortized monthly transition costs of the Customer Call Center, which totals $204,399, and the Shared Services Center costs in the amount of $76,584.[652] The CAPD projected close to the same amount of Other Deferred Debits using the actual booked amounts of the Company.[653]

Testifying for TAWC, Mr. Miller stated that Working Capital was calculated consistent with the Authority's ruling on this category in Docket No. 08-00039. He further noted that the amount projected included a provision based on the Lead-Lag Study performed by the Company in this case totaling $987,000.[654] The CAPD utilized the amount of the Lead-Lag Study provided by the Company but adjusted it to reflect a thirty-seven-day lag for the payment of state excise tax and federal income tax. The CAPD's witness, Mr. Buckner, stated that this methodology would align the payments with the corresponding statutory requirements. Using its forecasted revenue, expenses, and the tax lag adjustment, CAPD forecasted the Lead-Lag total to be $640,976.[655]

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[650] Sheila A. Miller, Pre-Filed Direct Testimony, p. 21 (September 23, 2010).
[651] Terry Buckner, Pre-Filed Direct Testimony, Workpaper RB-UNAMORTIZED DEBT EXPENSE, p. 100 (January 5, 2011).
[652] Sheila A. Miller, Pre-Filed Direct Testimony, p. 21 (September 23, 2010).
[653] Terry Buckner, Pre-Filed Direct Testimony, Workpaper RB-OTHER DEFERRED DEBITS, p. 97 (January 5, 2011).
[654] TAWC's February 22nd Supplemental Revised Accounting Exhibits and Workpapers, Revised Exhibit No. 1, Schedule 3, p. 1 of 6 (February 22, 2011).
[655] Terry Buckner, Second Amendment to Direct Testimony, Workpaper AMENDED RB-WORKING CAPITAL REQUIREMENT (Hearing Exhibit 90) (March 8, 2011).

Mr. Gorman, who testified for the City, asserted that Working Capital should be reduced by $2 million because the adjustment is necessary to reflect the removal of the unamortized debt expense, elimination of the non-cash items, and the use of different expense lag for various expenses, including management fees, in the Lead-Lag Study. Further, Mr. Gorman asserted that the unamortized debt expense was already included in the debt interest, and thus, its inclusion in working capital would allow TAWC double recovery of this expense. Further, Mr. Gorman set the expense lag for Depreciation and Amortization, Deferred Taxes, Net Earnings, Amortizations and Uncollectibles equal to the revenue lag. He then used a different expense lag for Management Fees and Gross Receipts taxes, asserting that the charges from the parent company should not be prepaid. Finally, Mr. Gorman asserted that Depreciation and Amortization, Deferred Taxes, Net Earnings, Amortizations and Uncollectibles should be removed from the Lead-Lag study because they are not cash expenses and, therefore, do not create a Cash Working Capital requirement.[656]

In rebuttal, TAWC asserted that the CAPD's adjustments to the Lead-Lag for income tax payments were inaccurate because they were based upon textbook recommendations that do not reflect the Company's current payment schedule.[657] TAWC also disagreed with Mr. Gorman's position, noting that its management contract with AWWSC requires advance payments. Further, TAWC asserted that Mr. Gorman failed to consider that if there were a lag in the payment to AWWSC, AWWSC would incur a lag in revenues that would then be passed back to TAWC. TAWC contended that the adjustment for uncollectibles that Mr. Gorman proposed was incorrect and represented the same position proposed by the CRMA in Docket No. 08-00039, which was not accepted by the TRA.[658] In addition, TAWC stated that it outlays cash when it purchases the non-cash items for depreciation and amortization and, therefore, the depreciation and

[656] Michael Gorman, Pre-Filed Direct Testimony, pp. 14-20 (January 5, 2011).
[657] Michael A. Miller, Pre-Filed Rebuttal Testimony, p. 52 (February 8, 2011).
[658] *Id.* at 53-54.

amortization allotment has already recovered the Company's initial cash investment. Finally, TAWC conceded that the gross receipts shown on the Lead-Lag were incorrect and corrected the service period in its rebuttal testimony.[659]

Considering the above, the panel adopts working capital in the amount of $1,675,829, broken down as follows:

Prepaid Taxes	$414,322
Materials and Supplies	215,798
Deferred Regulatory Expense[660]	852,847
Unamortized Debt Exp.	460,842
Other Deferred Debits	280,997
Lead-Lag Study	1,013,504
Incidental Collections	(1,562,481)
Total Working Capital	$1,675,829

With regard to these components, other than the Deferred Regulatory Expense and Lead-Lag amounts, the difference between the parties is attributable to the use of different test periods.

The category of Deferred Regulatory Expense consists of the unamortized balances of Regulatory Fees, Depreciation Study Expense, Management Audit Costs, deposition costs, and Cost of Service Studies. The panel finds that Regulatory Fees should be calculated using a thirteen-month average of the unamortized approved regulatory fees from Dockets No. 06-00290 and No. 08-00039, plus the thirteen-month average of the unamortized balance of the stipulated amount of $645,000. The panel further finds that Depreciation Study Expense should be calculated using the thirteen-month average of the unamortized balances from Docket Nos. 06-00290, 08-00039, and this docket. The use of these methods results in the panel's adoption of $852,847 for Deferred Regulatory Expenses within Working Capital.

Based upon the record, contrary to the CRMA's arguments, the panel finds that it is appropriate to include uncollectibles as an offset to revenues, the prepayment of Management charges, and Gross Receipt Taxes in the Lead-Lag Study. The panel does not agree that

[659] *Id.* at 55-56.
[660] This figure includes the cost of the management audit and the cost of Ms. Schumaker's deposition.

depreciation does not require a cash outlay and, therefore, should not be included in the Lead-Lag Study. Therefore, the panel adopts $1,013,504 for the Lead-Lag Study expense within Working Capital.

V(E)5. Accumulated Depreciation

The Company projected $72,578,044 for a thirteen-month average of Accumulated Depreciation. To calculate this amount, TAWC started with the historical balance of Accumulated Depreciation as of March 31, 2010 and applied actual depreciation rates to project monthly balances for the period ending December 31, 2011.[661]

The CAPD used the historical booked Accumulated Depreciation as of September 30, 2010, then applied current depreciation rates to determine monthly amounts through December 31, 2011. A thirteen-month average was calculated resulting in $73,137,622 as the final amount for Accumulated Depreciation.[662]

The differences between the parties as to Accumulated Depreciation are attributable to the use of different test periods. The Authority adopts the projection of $73,137,622 for Accumulated Depreciation based upon the later test period used by the CAPD.

V(E)6. Accumulated Amortization of Utility Capital Lease

There was no difference calculated between the parties on Accumulated Amortization of Utility Plant Capital Lease. Just as with the Capital Lease amounts, this amount agrees because the lease amounts are known and do not fluctuate. Therefore, this amount is not affected as a result of the use of different test periods. After reviewing the financial data, the Authority adopts $1,387,268 for the attrition period.

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[661] Sheila A. Miller, Pre-Filed Direct Testimony, pp.21-22 (September 23, 2010).
[662] Terry Buckner, Pre-Filed Direct Testimony, Workpaper RB-ACCUMULATED DEPRECIATION, p. 102 (January 5, 2011).

V(E)7. ACCUMULATED DEFERRED INCOME TAXES (ADIT)

In its *Petition*, TAWC filed Accumulated Deferred Income Taxes ("ADIT") on a non-SFAS 109 basis and asserted that the Authority recognized SFAS 109 accounting as to ADIT. Nonetheless, TAWC did not recognize the amortizations associated in calculating the federal income tax expense in the 2008 rate case. In addition, TAWC included a deferred expense and an expense related to the tax accounting treatment of "Capitalized Repairs" consistent with FIN 48.[663] Subsequently, on February 22, 2011, TAWC revised its estimated ADIT amount to be consistent with SFAS 109. The subsequent filing resulted in two primary differences between TAWC and the CAPD related to ADIT: the treatment of SFAS 109[664] and FIN 48[665] recognition.

As summarized by TAWC, SFAS 109 addresses the flow-through rate recovery of pre-1981 property.[666] The difference between straight-line method depreciation and the accelerated depreciation that is allowed by the IRS creates a timing difference.[667] As the ratepayers received the benefit of accelerated depreciation, a regulatory asset must be established to account for the timing difference and to facilitate the appropriate reversal in subsequent years.[668]

Until the reversal of depreciation, SFAS 109 allows the Company to reduce its ADIT by the amount of the regulatory assets, which allows the Company to earn a return on the timing difference until reversal.[669] As the timing difference reverses, the regulatory asset account steadily is reduced and the income tax expense steadily increases.[670] Because the Company's current taxes for rate recovery have always included the additional income taxes paid to the IRS

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[663] Michael Miller, Pre-Filed Direct Testimony, p. 58 (September 23, 2010).
[664] Financial Accounting Standards Board (FASB) Statement No. 109.
[665] Financial Accounting Standards Board Interpretation No. 48.
[666] Michael A. Miller, Pre-Filed Rebuttal Testimony, p. 36 (February 8, 2011).
[667] *Id.* at 35.
[668] Accelerated depreciation temporarily reduces current income tax expense, thus reducing the expense that must be recovered from ratepayers. *Id.* at 39.
[669] *Id.*
[670] *Id.*

on the reversal of the pre-1981 property by the TRA under the APB11[671] approach to rate recovery, the Company established the SFAS 109 tax assets as regulatory assets under the provisions of SFAS 71, which allows regulatory assets to be established if future rate recovery is probable.[672]

In accordance with FIN 48, AWWC changed the accounting method it used for recording repairs and maintenance. Instead of capitalizing the costs, as it had previously done, TAWC deducted the costs in the current year.[673] This change creates an uncertainty regarding the lawfulness of the deduction.[674] FIN 48 allows the creation of a reserve for a portion of the capitalized repairs in order to allow payment of any future potential tax liability.[675] FIN 48 requires the Company to identify any uncertain tax positions, evaluate them, and determine whether the IRS is likely to sustain a deduction.[676] If uncertainty exists, FIN 48 allows the Company to exclude this amount as a deduction from rate base, thus earning a return on a potential repayment.[677]

The CAPD originally filed a calculation of ADIT that did not adjust the amount of regulatory assets or include capitalized repairs.[678] Later, the CAPD amended its ADIT calculation to include the regulatory assets, but continued to include capitalized repairs in ADIT.[679] Additionally, the CAPD included a timing difference for Capitalized Repairs and Post-80 depreciation in its calculations. The CAPD did not offer testimony to explain why these adjustments were necessary.

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[671] Accounting Principles Board Opinion 11.
[672] Michael A. Miller, Pre-Filed Rebuttal Testimony, p. 39 (February 8, 2011).
[673] *Id.* at 41.
[674] FIN 48, § A26.
[675] James I. Warren, Pre-Filed Rebuttal Testimony, p. 35 (February 8, 2011).
[676] *Id.*
[677] Michael A. Miller, Pre-Filed Rebuttal Testimony, p. 41 (February 8, 2011).
[678] *Id.*
[679] *Id.*

The TRA agrees with TAWC that the CAPD's amended filing appropriately reduced rate base by the total of the Company's ADITs (liabilities) as is reflected on the Company's financial statements using the SFAS 109 approach. Nevertheless, the CAPD failed to appropriately offset this amount by the SFAS 109 (regulatory) assets to account for reversal of the timing differences related to the pre-1981 flow-through property.

The TRA, therefore, agrees with both TAWC and the CAPD that, consistent with SFAS 109 and SFAS 71, regulatory asset accounts should be recognized when computing ADIT, and adopts the SFAS 109 approach to calculating income taxes, which recognizes regulatory assets in determining the ADIT balance. The TRA also agrees with TAWC that FIN 48 amounts represent a tax that the Company owes, with interest, as to previously filed tax returns. No documentation or justification was provided that the repairs deduction for federal income tax expense is uncertain or may not result in reversal. Further, there were no challenges made to the calculation of this FIN 48 amount. Therefore, the TRA concludes that the capitalized repairs deduction should not be used to reduce rate base. Thus, utilizing the regulatory assets in its determination of the ADIT balance and applying FIN 48, the TRA adopts Accumulated Deferred Income Tax in the amount of $22,638,057.

V(E)8. Customer Advances for Construction

Initially, TAWC and the CAPD disagreed as to the proper amount for Customer Advances for Construction. On February 8, 2011, although TAWC filed rebuttal testimony on its projected attrition period amount, which included exhibits, a discrepancy remained between TAWC's calculation and the CAPD's proposed amounts. On February 22, 2011, TAWC filed a revised exhibit that contained an updated amount of $5,786,757 for Customer Advances for Construction, but did not include any testimony to support the change.[680] Nevertheless these

[680] TAWC's Supplemental Revised Accounting Exhibits and Workpapers, Revised Exhibit No. 1, Schedule 2, p. 1 (February 22, 2011).

revisions demonstrate an agreement between the TAWC and CAPD on the amount. Based on a review of the financial data, and considering that the parties are now in agreement, and the reasons noted previously concerning the appropriate test period, the Authority adopts $5,786,757 as the total of Customer Advances for Construction.

V(E)9. Contributions in Aid of Construction

TAWC and the CAPD also initially disagreed regarding the amount to be used for Contributions in Aid of Construction ("CIAC"). On February 8, 2011, TAWC filed rebuttal testimony with exhibits, wherein TAWC's revised amount still differed from the amount projected by the CAPD. On February 22, 2011, TAWC filed a revised exhibit with an updated amount of $9,932,550 for CIAC, without any testimony to support the change.[681] With the second revision, TAWC and the CAPD agree as to the projected total. Considering the financial data, the fact that the parties are now in agreement, and the reasons noted previously as to the appropriate test period, the Authority adopts $9,932,550, as proposed by TAWC and the CAPD, for the CIAC amount.

V(E)10. Unamortized Investment Tax Credit ("UITC")

Initially, there was disagreement between TAWC and the CAPD regarding the proper amount to be used for Unamortized Investment Tax Credits. Nonetheless, on February 8, 2011, TAWC filed a rebuttal exhibit that contained an attrition period amount that is identical to that determined by the CAPD, but did not file supporting testimony.[682] Based on a review of the financial data, the fact that the parties are now in agreement, and reasons previously noted as to the appropriate test period, the TRA adopts $26,899 for Unamortized Investment Tax Credits.

V(E)11. Utility Plant Acquisition Adjustment

The differences between the parties as to the Utility Plant Acquisition Adjustment are due

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[681] *Id.*

[682] Michael A. Miller, Pre-Filed Rebuttal Testimony, Exhibit MAM-9 (February 8, 2011).

to the use of different test periods. Upon review of the financial data and for the reasons previously noted regarding the appropriate test period, the Authority adopts $74,850 for Utility Plant Acquisition Adjustment.

V(F). REVENUE CONVERSION FACTOR

Based upon the CAPD's methodology, the panel adopts an overall Revenue Conversion Factor of 1.643037 for the attrition year, a Forfeited Discount Factor of 0.0081 to reflect the CAPD's Normalized Test Year Late Payment Penalty/CAPD's Normalized Test Year Total Sales of Water, an Uncollectible Factor of 0.0066 to reflect the CAPD's Normalized Test Year Uncollectibles/CAPD's Normalized Test Year Total Sales of Water, a state excise tax of 6.5%, and an FIT of 35%.

V(G). RATE OF RETURN

To establish a fair rate of return, the following three steps are performed: (1) determination of an appropriate capital structure; (2) calculation of the cost rates of each component of the capital structure: (i) short-term debt, (ii) long-term debt, (iii) preferred equity, and (iv) common equity; and (3) computation of the overall cost of capital using a weighted average of the component rates to account for the proportion of each component.[683]

TAWC requested an overall rate of return of 8.38%.[684] The Company's request was based upon the capital structure of TAWC. The Company proposed a capital structure for TAWC that consisted of: 51.386% long-term debt; 3.453% short-term debt; 1.126% preferred equity; 24.345% common equity in the form of common stock; and 19.690% common equity in the form of retained earnings.[685] TAWC proposed a short-term debt cost of 1.9% based upon market forecasts for 2011 and recent short-term debt rates from American Water Capital

[683] The legal basis on which the Authority determines a utility's fair rate of return is set forth in Section III, above.
[684] Michael A. Miller, Pre-Filed Direct Testimony, Exhibit MAM-5 (September 23, 2010).
[685] *Id.*

Corporation ("AWCC").[686] The proposed cost of long-term debt is 6.2% and includes a proposed $9 million debt offering at 6.212%, which is anticipated to be issued in late 2010, and an $8.0 million issue at 6.612% targeted for November 2011.[687]

In deriving its recommended cost of capital of 8.38%, TAWC claimed that its return on equity should be set at 11.5%, as it is within the range of equity returns suggested by Company witness Dr. Vander Weide.[688] Dr. Vander Weide used the Capital Asset Pricing Model ("CAPM") and the Discounted Cash Flow ("DCF") model to determine the appropriate cost of capital for TAWC.[689] Dr. Vander Weide also employed risk premium models based upon the required spread above a fixed income instrument, like a utility bond, to form his cost of equity recommendation.[690]

When choosing growth rates for use in the DCF analysis, Dr. Vander Weide used forecasts by stock analysts, rather than historical measures, in reliance on economic research suggesting that analyst forecasts are the best estimates of investors' expectations.[691] He also included a 5% allowance for flotation costs in his DCF analysis.[692]

Dr. Vander Weide used a sample of water companies and found that the average DCF cost of equity is 12.3%,[693] which was found to increase to 13.3% when the average is computed with weights based upon market capitalization.[694] When the DCF model is applied to his sample of natural gas utilities, the average cost of equity is 11.1%, and falls to 10.9% when calculated on a market weighted basis.[695] He proposed a cost of equity estimate of 11.2% using the ex post

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[686] *Id.*
[687] *Id.*
[688] *Id.*
[689] Dr. James H. Vander Weide, Pre-Filed Direct Testimony, p.3 (September 23, 2010).
[690] *Id.* at 29.
[691] *Id.* at 18.
[692] *Id.* at 20.
[693] *Id.* at 25.
[694] *Id.* at 25-26.
[695] Dr. James H. Vander Weide, Pre-Filed Direct Testimony, p. 28 and Schedule 2-1 (September 23, 2010).

risk premium method.[696] Based upon the results of his DCF analysis of water and natural gas companies, and using an ex ante risk premium and ex post risk premium analysis, Dr. Vander Weide determined a cost of equity for TAWC is in the range of 10.9% to 12.3%[697]

Dr. Vander Weide criticized CAPD witness Dr. Klein's DCF analysis and claimed that it is inappropriate to use an annual DCF model instead of a quarterly DCF model.[698] Dr. Vander Weide further stated that the CAPD did not properly implement the DCF model because it did not adjust the current yield component of the calculation by the expected growth rate,[699] which, in his view, leads to an understatement of the cost of equity of 25 basis points.[700] He also criticized Dr. Klein's use of Value Line forecasts of dividend growth, asserting that they are inferior to analysts' estimates of earnings growth.[701] He argued that the CAPD should have used earnings growth estimates instead of dividend growth forecasts, claiming that earnings growth forecasts are more accurate.[702]

Dr. Vander Weide argued that the use of double-leverage is inconsistent with financial theory.[703] Additionally, TAWC witness Mr. Miller asserted that the use of double-leverage is inappropriate and could prevent the Company from recovering its true cost of capital.[704] Mr. Miller noted that Dr. Klein did not implement double leverage in the same way the TRA has done in previous TAWC rate cases.[705] Mr. Miller asserted that Dr. Klein used the stand-alone capital structure for TAWC, adjusted to impose the cost of capital for AWW Parent (i.e. a non-consolidated entity) to total equity of TAWC,[706] which, in Mr. Miller's opinion resulted in a

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[696] *Id.* at 37.
[697] *Id.* at 44-45.
[698] *Id.* at 7-8.
[699] *Id.* at 8-9.
[700] Dr. James H. Vander Weide, Pre-Filed Rebuttal Testimony, pp. 8-9 (February 8, 2011).
[701] *Id.* at 9.
[702] *Id.* at 9-10.
[703] *Id.* at 24-30.
[704] Michael Miller, Revised Pre-Filed Rebuttal Testimony Amendment, p. 19 (February 17, 2011).
[705] *Id.* at 21-22.
[706] *Id.* at 18.

drastic decrease in the equity ratio of the capital structure relative to the approach adopted by the TRA in previous cases.[707] Mr. Miller further stated that the CAPD's use of a historical average capital structure is inappropriate because it is not consistent with the known and measurable test,[708] and that the CAPD's technique artificially inflates the impact of low-cost short term debt on TAWC's capital structure.[709]

As stated above, CAPD witness Dr. Chris Klein utilized a double-leverage methodology that imputed the capital structure and associated cost of capital of TAWC's parent AWWC to the equity portion of TAWC's capital structure.[710] Dr. Klein recommended using the historical capital structures of both TAWC and AWWC in his double-leverage calculation.[711] Dr. Klein's historical capital structure for TAWC contains 6.45% short-term debt, 48.71% long-term debt, 1.24% preferred stock and 43.6% equity.

Dr. Klein adopted the costs of short-term debt, long-term debt, and preferred stock for TAWC, as was proposed by Company witness Mr. Miller,[712] and posited the cost of long-term debt for TAWC's parent to be 6.27%.[713] The CAPD estimated the cost of equity for AWWC using the familiar DCF and CAPM models. Like TAWC witness Dr. Vander Weide, Dr. Klein used proxy groups from both the water and natural gas industry.[714]

For his DCF estimates, Dr. Klein uses historical dividend data to estimate dividend growth of 5% for AWWC.[715] Using the dividend yield range of 3.5% to 3.7%, Dr. Klein computes DCF cost of equity estimates for AWWC with a range of 8.5% to 8.7%.[716] Dr. Klein

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[707] *Id.* at 21-22.
[708] *Id.* at 25.
[709] *Id.*
[710] Dr. Christopher C. Klein, Corrected Pre-Filed Direct Testimony, p. 5 (January 24, 2011).
[711] *Id.*
[712] *Id.*
[713] *Id.* at Corrected Exhibit p. 2 of 19; *see also* Dr. Christopher C. Klein, Corrected Pre-Filed Direct Testimony, p. 9 (January 24, 2011).
[714] Dr. Christopher C. Klein, Corrected Pre-Filed Direct Testimony, pp. 10-11 (January 24, 2011).
[715] *Id.* at 12.
[716] *Id.*

indicates that the "... minimum DCF cost of equity for AWWC is approximately 8.6%. This is similar to the midpoint of the DCF range for natural gas utilities (8.65%) and just lower than the midpoint for large water companies (9.1%)."[717]

For the CAPM, Dr. Klein selects his proxy for risk-free interest rates to be the yield on 5 year Treasury bonds which was 2.1% at the time his testimony was filed.[718] Dr. Klein sets the market risk premium at 7.1% using data taken from the familiar 2010 Ibbotson SBBI Stocks, Bonds, Bills and Inflation Valuation Yearbook. Dr. Klein indicates that the BETA statistic of AWWC, as reported by Value Line, is 0.65.[719] Using this data, Dr. Klein calculates an equity return of 6.72% for AWWC. Dr. Klein notes that "... the comparable water and natural gas utilities all have very similar CAPM cost of equity estimates between 6.36% and 7.78%."[720] Dr. Klein notes that current low interest rates may lead to an understatement of the required equity return.[721] Dr. Klein further notes that there is some evidence that the CAPM may underestimate the cost of equity for firms, like utilities, that have BETA statistic less than one.[722] Dr. Klein observes that it is reasonable to expect that the cost of equity for utilities is still less than the market portfolio (BETA =1) which he calculates as 9.2%.[723]

Dr. Klein ultimately recommends a 9.0% ROE for AWWC as it is the midpoint of the range his CAPM and DCF estimates taken as a group.[724] Dr. Klein also notes that his 9.0% equity return recommendation is within the bounds of his DCF estimates for water utilities (9.1%) and natural gas utilities (8.65%).[725]

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[717] *Id.*
[718] *Id.* at 14-15.
[719] *Id.* at 7 of 19.
[720] *Id.* at 15.
[721] *Id.*
[722] *Id.*
[723] *Id.* at 14-15.
[724] *Id.* at 15-16.
[725] *Id.*

Dr. Klein disputed several of the conclusions reached by Dr. Vander Weide. First, Dr. Klein stated that some of the companies used in TAWC's comparison group were not representative of TAWC or AWWC.[726] He also took issue with the risk premium analysis that formed the basis of TAWC's CAPM estimates. He questioned TAWC's reliance on long-term Treasury bonds, which, he stated introduces interest rate risk and, thus, cannot be risk free.[727] Finally, Dr. Klein criticized TAWC's use of quarterly dividend payments and flotation costs.

CRMA Witness, Mr. Gorman, noted that the TRA has a long-standing practice of using a double-leveraged capital structure in setting TAWC's overall cost of capital.[728] Mr. Gorman argued that TAWC's requested 11.5% equity return is not reasonable relative to the 10.2% equity return awarded in the last rate case.[729] To support his argument, Mr. Gorman provided data to show that authorized returns on equity for electric and gas utilities, as well as utility bond yields on "A" and "Baa" rated instruments, have decreased since TAWC's last rate filing.[730]

The Union suggested that TAWC's equity return should be penalized if it does not maintain the staffing levels established by the TRA. Mr. Lewis opined, ". . . [if] the Company fails to maintain a workforce level consistent with its authorized level, absent a showing of exigent circumstances, TAWC should be subject to a penalty. The penalty, could, for example, take the form of a reduction in the return on equity component of its rates."[731]

V(G)1. CAPITAL STRUCTURE

The TRA traditionally recognizes the importance of the parent-subsidiary relationship when determining capital structure. To reflect the relationship between TAWC and its parent company, the panel uses double-leverage capital structure methodology. The TRA was not persuaded by the Company's witnesses, Dr. Vander Weide's and Mr. Miller's, criticism of the

[726] *Id.* at 16-17.
[727] *Id.* at 17-18.
[728] Michael Gorman, Pre-Filed Direct Testimony, p. 22 (January 5, 2011).
[729] *Id.*
[730] *Id.*
[731] James Lewis, Pre-filed Direct Testimony (Public Version), p. 20 (January 5, 2011).

use of the double-leverage methodology. The Company failed to offer any new arguments in this case that would persuade the Authority to depart from its well-established precedent.

To implement the double-leverage calculation, it is necessary to determine the elements of TAWC's capitalization that are held by AWWC and those held by outside parties. In making these calculations, the TRA adopts the calculation of Mr. Miller that 6.81% of TAWC's capitalization is debt held by entities outside the AWWC corporate family. The next step in implementing the double-leverage methodology is to determine the capital structure of the TAWC's parent company, AWWC. The calculated historical capital structure for AWWC, set forth by CAPD Witness Dr. Klein, is deemed to be the appropriate structure to use in this proceeding.[732] Therefore, the TRA finds that the capital structure for AWWC is composed of 2.63% short-term debt, 53.13% long-term debt, 0.25% preferred stock, and 43.99% common equity. Given the impact of the crisis in the financial markets, the use of a historical capital structure for AWWC will be more reflective of its long run capital structure than using a single point in time to determine its capital structure.

V(G)2. COST OF DEBT

TAWC witness Mr. Miller's approach of measuring spreads between the Federal Funds rate and rates for outstanding short-term debt and then applying those spreads to forecasts of the Federal Funds rate, is inherently reasonable and provides a mechanism for incorporating prospective changes in often volatile short-term interest rates into the rate-setting process. Mr. Miller used the same approach in forecasting short-term debt rates as was used in the previous TAWC rate case. CAPD witness Dr. Klein deemed Mr. Miller's estimates to be reasonable for use in his own analysis. Thus, the TRA adopts a short-term debt rate of 1.9% for use in this proceeding. Additionally, the panel adopts a long-term debt rate of 6.27% as proposed by Dr. Klein, who concluded that this percentage represents that 6.27% is the embedded cost of

[732] Dr. Christopher C. Klein, Corrected Pre-filed Direct Testimony, Corrected Exhibit p. 4 of 19 (January 24, 2011).

AWWC's debt. The rate is very similar to the 6.2% figure for the subsidiary, TAWC, which would be expected to have a cost of debt that is very similar to that of its parent.

V(G)3. RETURN ON EQUITY

Finally, the last piece of information needed to determine the weighted cost of capital for AWWC is the appropriate equity return. TAWC requested an 11.5% equity return. CAPD witness Dr. Klein proposed a 9% equity return. CRMA witness Mr. Gorman does not make a specific recommendation, but he argued that the Company's requested return is unreasonable. There is no simple single-step process for setting the appropriate equity return. Therefore, the TRA looks at the results of the parties' models, prevailing economic conditions, and other factors that may provide evidence about the risk of investing in either AWWC or TAWC.

The TRA considered the CAPM result for AWWC. For its CAPM calculation, the Authority adopts a risk-free return of 4.75% for use in the CAPM calculation as proposed by Dr. Vander Weide and used in his CAPM analysis. For the market risk premium, the Authority uses the 7.1% long-run risk premium produced by Ibbotson Associates and referenced by Dr. Klein. This risk premium statistic is slightly below the mid-point of the two risk premium statistics, 6.7% and 7.75%, used by Dr. Vander Weide in his CAPM analysis. Finally, the Authority uses the Beta value of 0.65 for AWWC found in Dr. Klein's testimony. With the information described above, the result is an equity return for TAWC's parent of 9.4%, which is 80 basis points below the 10.2% equity return adopted by the TRA in the last TAWC rate case. This figure increases to 9.8% when using the Beta statistic used in Dr. Vander Weide's analysis. The TRA considers the 9.4% equity return estimate to be a useful floor in setting the equity return in this proceeding.

The TRA disagrees with Dr. Vander Weide's complete rejection of the CAPM and finds that the low Beta statistics associated with comparable companies and AWWC, provides useful information as to the risk of water companies relative to the market. While both witnesses assert

that the CAPM may underestimate the cost of equity for firms with low Beta statistics, the TRA has used the CAPM with such values in the past and no new theory or empirical evidence has been presented to discourage the TRA from adopting the practice again in this case.

The Authority does not adopt Dr. Vander Weide's use of the quarterly DCF model, and instead uses the simple annual DCF model because unlike the quarterly model, the annual model does not inflate the implied cost of equity. The Authority does not adopt the ex ante and ex post risk premium results reached by Dr. Vander Weide because they are not specific to AWWC, the water proxy group, or the natural gas proxy group upon which he based his analysis. The TRA and its predecessor, the Tennessee Public Service Commission, have rejected adding flotation costs to the return on equity when there is no accompanying stock issuance.[733] During the hearing, TAWC witness Mr. Miller indicated that he is unaware of an offering by AWW.[734] According to TAWC, it planned to issue $0.622 million and $2 million in equity in both 2011 and 2012, respectively.[735] Since AWW holds the common stock of TAWC, the equity issuance is an internal transaction and, therefore, it is not necessary to include flotation costs.

The Authority does not agree with the CAPD's CAPM calculations because CAPD used short-term interest rates as a proxy for risk-free return. Instead, the Authority prefers to use longer-term interest rates as a proxy for risk-free return as it more closely matches the expected life of a security, such as a stock or an investment in utility plant. Further, short-term interest rates are likely to increase from the current unprecedented low levels that have been set by the Federal Reserve to combat the recent economic downturn.

TAWC witness Mr. Miller suggested that there has been a predictable spread between A-rate utility bonds and equity returns awarded by state commissions. Using this relationship,

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[733] *See In re: Petition of Chattanooga Gas Company for Approval of Adjustment of its Rates and Charges and Revised Tariff*, Docket No. 04-00034, *Order*, pp. 57-58 (October 20, 2004).
[734] Transcript of Proceedings, Vol. VI B, pp.171-172 (March 7, 2011).
[735] TAWC's Responses to the TRA's Data Requests Dated September 20, 2010, Question 82 (October 4, 2010).

based on current bond rates, Mr. Miller calculated a 10.36% equity return if the average spread is maintained.[736] The Authority finds Mr. Miller's testimony to be useful in setting the equity return, as it provided useful information on equity returns awarded to comparable companies. Mr. Miller calculated the average equity return awarded since June 2009 to AWWC subsidiaries to be 10.36%.[737] When restricting Mr. Miller's analysis to decisions with orders issued in 2010, the average awarded equity return decreased to 9.95%. In the most recent decision listed in Mr. Miller's exhibit, Kentucky American was awarded a 9.7% return on December 14, 2010.[738]

Given the range of equity estimates provided by the witness and recent decisions reached by other state regulatory commission, the Authority adopts a 10% equity return in this proceeding. Relative to the last TAWC rate proceeding, AWWC has become less risky as measured by its Beta statistic, thus implying that the required equity return has decreased since the last case. While the most recent decision in the Kentucky American case was a 9.7% equity return, the TRA is concerned that interest rates will generally be increasing as government monetary policy normalizes.

The Authority rejects the Union's suggestion that equity return be adjusted if employment levels fall below the level authorized by the TRA. First, many factors outside the control of TAWC, such as retirements, can alter employment levels. The Company demonstrated at the Hearing that a lengthy process is required to hire for union positions, which can result in vacancies and could result in further delays in meeting authorized employment levels. Secondly, altering base rates to account for employment levels will be costly to implement. Finally, the Authority was concerned that implementing an equity return adjustment

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[736] Michael A. Miller, Pre-Filed Rebuttal Testimony, Rebuttal Exhibit MAM-5 (February 8, 2011).
[737] *Id.*
[738] *Application of Kentucky-American Water Company for an Adjustment of Rates Supported by a Fully Forecasted Test Year*, Case No. 2010-00036, Kentucky Public Service Commission, *Order*, p. 71 (December 14, 2010).

to employment levels might introduce inefficiencies into the operations of TAWC by requiring the Company to maintain specific employment levels even when not warranted.

Based on its analysis of relevant debt and equity costs, The Authority determines that an equity return of 10% and overall cost of capital of 7.83% based upon a double-leveraged capital structure is just and reasonable.[739]

V(H). REVENUE DEFICIENCY

Based upon the preceding findings, a majority of the panel[740] determines that the Revenue Deficiency is $5,551,013 for the attrition period.[741]

V(I). RATE DESIGN

The Company requested a $9.984 million increase in annual revenues, which is approximately equal to a 26.77% increase in rates. The requested rates would increase the Chattanooga tariff rates, the Lakeview tariff rates, and the Lookout Mountain tariff rates.[742] With few exceptions, the base rate for these areas would increase approximately 27% to 28%. The Company also recommended merging the mountain-serving areas into one tariff to reflect the similar characteristics of those areas.[743] The proposed volumetric usage increases vary greatly for these three locations depending on the service area and rate band.[744] The Company requested that tariff rates be established for Suck Creek and Lone Oak.[745] In addition, the Company recommended that it be allowed to merge the tariffs for Lone Oak and Suck Creek into the Mountain Tariff by adopting the basic blocking structure and volumetric rates.[746]

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[739] Director Roberson dissented and voted that the return on equity be set at 9.65% and an overall rate of return of 7.68%. This would reduce the revenue increase necessary by $282,961. Transcript of Proceedings, p. 76 (April 4, 2011).

[740] Director Roberson dissented from the majority's calculation of the dollar amount, but agrees with the methodology used to perform the calculation.

[741] Director Roberson voted to adopt a revenue deficiency for the Company of $4,242,134, thereby reducing the total rate increase from 14.76% to 11.29% for customers. Transcript of Proceedings, p. 76 (April 4, 2011).

[742] John S. Watson, Pre-Filed Direct Testimony, p. 4 (September 23, 2010).

[743] Paul R. Herbert, Pre-Filed Direct Testimony, p. 11 (September 23, 2010).

[744] *Petition*, Exhibit No. 4, Schedule 2 (September 23, 2010).

[745] John S. Watson, Pre-Filed Direct Testimony, p. 4 (September 23, 2010).

[746] Paul R. Herbert, Pre-Filed Direct Testimony, p. 11 (September 23, 2010).

Further, the Company requested that individual rates be set for four large resale customers that receive service under special contracts approved by the TRA. The sale for resale customers are the Town of Signal Mountain, Tennessee, Walden's Ridge Utility District, Tennessee, City of Fort Oglethorpe, Georgia, and the Catoosa Utility District Authority, Catoosa County, Georgia.[747] The CAPD asserted that ". . . any change in revenue requirements ordered by the TRA in this docket [should] be spread uniformly to all customer classes and customer locations."[748]

Following the initial announcement by TAWC and the CRMA on February 28, 2011 that a settlement had been reached between them, the CRMA later submitted a summary of the proposed settlement agreement during the conclusion of the hearing on March 8, 2011, a copy of which was attached to that day's transcript[749] The settlement agreement proposed to increase the meter charges and volumetric rates of TAWC's small industrial customers, while, in turn, decreasing the meter charges and volumetric rates of larger industrial customers. The settlement affirmed that the other parties actively involved in this case do not object to the proposed settlement. As proposed, the settlement agreement applied exclusively between TAWC and the members of the CRMA. In its petition to intervene, the CRMA stated that it represents ". . . 250 manufacturers and businesses supporting and servicing the local area's manufacturing sector."[750]

On March 25, 2011, a *Notice of Convening Panel* was issued, providing public notice that the panel would be convening on April 4, 2011 to deliberate the merits of the *Petition.*[751] During the proceedings held on April 4, 2011, as to the proposed settlement agreement, the panel determined that not all industrial customers of TAWC were also members of the CRMA, and that filing the proposed settlement during the hearing did not provide adequate notice or

[747] John S. Watson, Pre-Filed Direct Testimony, p. 3 (September 23, 2010).
[748] Terry Buckner, Pre-Filed Direct Testimony, pp. 62-63 (January 5, 2011).
[749] *Summary of Settlement between CRMA and TAWC* (March 28, 2011).
[750] *Petition to Intervene by the Chattanooga Manufacturers Association* (October 4, 2010).
[751] *Notice of Convening Panel* (March 25, 2011).

opportunity for response to non-members. In addition, the settlement was submitted late during the hearing proceedings, and neither party had presented a witness to testify as to the terms and conditions of the settlement, thereby preempting an opportunity for the Authority to ask questions concerning the proposed settlement agreement.[752]

While it appeared that the proposed settlement would likely be revenue neutral within the industrial class of consumers, except insofar as it seems that smaller users will absorb a higher percentage of the revenue increase than larger users, the panel was not able to determine its effects on individual users within the class. This issue had not been discussed by the parties, and the proposals included within the settlement were not raised during the discovery process. TAWC is the only party that provided testimony as to possible rate designs, but its testimony related more to what a minimal impact its requested rate increase would have on existing customers and did not provide a comparison of rates or a proper distribution of any potential revenue changes.

After due consideration and review of the record, the Authority declined to approve the proposed settlement because it was filed improperly as an exhibit, failed to include necessary information as to the structure and impacts of the proposals therein, and was designed to affect only rates within the industrial customer class.[753] As a result, the Authority requested that the Company file two separate price-out tariffs that reflected the impacts of the proposed rate results and approved revenue changes: one tariff that demonstrated the impacts to rates in the event that the settlement agreement was denied, and one tariff that showed the impacts to rates should the panel approve the settlement agreement.[754] On April 6, 2011, TAWC filed both price-out tariffs as ordered by the Authority.

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[752] The parties later filed a *Summary of Settlement between CRMA and TAWC* in the docket file on March 28, 2011.
[753] Transcript of Proceedings, pp. 8-9 (April 4, 2011).
[754] *Id.* at 84.

On April 7, 2011, the UWUA filed an objection to the tariffs and asserted that both of the proposed tariffs failed to incorporate the reporting conditions related to staffing and valve maintenance issues that had been previously ordered by the Authority during its April 4, 2011, Authority Conference. On April 14, 2011, TAWC filed its response in opposition to the UWUA's objection. During its regularly scheduled Authority Conference held on April 18, 2011, the Authority overruled the UWUA's objection to the tariffs with regard to TAWC's failure to incorporate staffing and valve maintenance reporting requirements, and based on TAWC's agreement with a request by the UWUA, the panel ordered that the semiannual staffing and valve maintenance reports be filed on April 5th and October 5th of each year. The panel reasoned that the reporting requirements will be included in the Final Order and it is inappropriate and contrary to past practices of the TRA to include such terms in the tariff. Subsequently, the Authority approved the proposed settlement agreement filed by the CRMA and TAWC and the filed tariff that reflected the terms of the settlement agreement.[755]

Next, the Authority denied the Company's originally proposed tariff and ordered the Company to file a new tariff within thirty (30) days with new rates sufficient to produce incremental revenues in the amount of the revenue deficiency, as noted above. The Authority ordered that the tariff filing must be accompanied by a detailed price-out reflecting the new rates based upon attrition year billing determinates and accurately producing incremental revenues in the amount of the revenue deficiency approved by the Authority when compared to attrition year billing determinates at current rates.

IT IS THEREFORE ORDERED THAT:

1. The rates filed by the Tennessee American Water Company on September 23, 2010, are denied.

[755] Director Kyle voted against the settlement agreement and moved to adopt the tariff to reflect an across-the-board increase to all customer classes and individual rates. Transcript of Proceedings, p. 12 (April 18, 2011).

2. For purposes of the rates set forth herein:

(a) The test period utilized shall vary according to the Authority's determinations herein as to the period that best fits each of the individual items being forecasted.

(b) The attrition period shall be for the twelve months ended December 31, 2011.

(c) The rate base is set at $118,459,808 and the net operating income is $5,937,860 at current rates.

(d) Capitalization of debt held by parties outside of the American Water Works Company, the corporate parent of Tennessee American Water Company, system is 6.81%, with a cost of 8.30%.

(e) The capital structure for American Water Works Company is composed of 43.99% common equity, 53.13% long-term debt, 2.63% short-term debt, and 0.25% preferred stock.

(f) An equity return of 10%[756] and an overall rate of return of 7.83% based upon a double-leveraged capital structure, are just and reasonable and hereby set for Tennessee American Water Company.

3. The Revenue Conversion Factor is 1.643037, and results in a Revenue Deficiency of $5,551,013, which allows the Company an opportunity to earn a fair return on its investment during the attrition year.[757]

4. The Revenue Deficiency shall be implemented by uniform percentage increases to base rates and volumetric rates for all customer classes.

5. (a) Tennessee American Water Company shall submit semi-annual staffing level reports to the Utility Division Chief on April 5th and October 5th of each year. Such reports shall include (1) the actual number of full-time equivalent employees for the previous period, by

[756] Director Roberson dissented from the decision of the majority of the panel.
[757] Director Roberson dissented from the decision of the majority of the panel.

month, (2) an explanation concerning any differences between the authorized and actual full-time equivalent employees, and (3) a date by which Tennessee American Water Company expects to fill any vacant positions.

(b) Tennessee American Water Company shall also semi-annually report to the Utility Division Chief concerning the progress of its valve operation and maintenance program. The report shall include (1) the current number of employees assigned to the valve program, by month, (2) the number of larger and smaller valves targeted for inspection, operation, and maintenance during the previous period, by month, (3) the number of valves actually inspected, operated, and maintained during the current period, by month, (4) the number of valves discovered or known to be in need of repair or replacement, by month, (5) the date of repair or replacement of such valves, and (6) in the event that Tennessee American Water Company did not to repair or replace certain valves, the number of valves that were not repaired or replaced and a detailed explanation of the reason(s) that action was not taken.

6. Tennessee American Water Company is hereby directed to file a tariff with the Authority that implements recovery of $275,000 in regulatory expense through a separate line item charge that will be reflected on customer bills in all customer classes for a six-month period and will automatically cease upon full recovery.

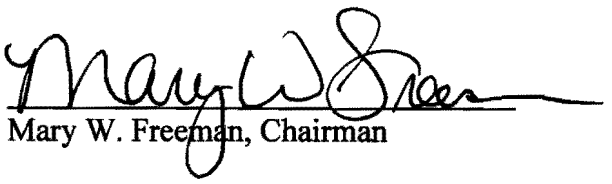
7. Tennessee American Water Company is hereby directed to file with the Authority tariffs that produce an increase of $5,551,013 in incremental revenues for service rendered, and any other tariffs necessary and consistent with this Order.

8. All tariffs shall be filed within thirty days.

9. Any party aggrieved by the decision of the Tennessee Regulatory Authority in this matter may file a Petition for Reconsideration within fifteen days of the date of this Order.

10. Any party aggrieved by the 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

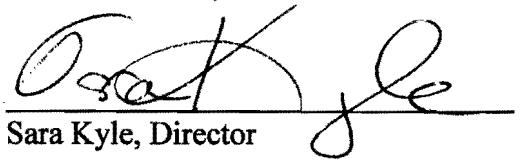
days of the date of this Order.



Mary W. Freeman, Chairman

* * *

Eddie Roberson, Director[758]



Sara Kyle, Director

[758] Director Roberson declined to vote with the majority in granting TAWC a revenue requirement in the amount of $37,614,978 for the reasons set forth in his *Concurrence and Dissent of Director Eddie Roberson* filed herewith. Director Roberson voted with the majority in approving the rate design as set forth above.

1977 WL 440900 (Tenn.P.S.C.), 22 P.U.R.4th 281

Re South Central Bell Telephone Company
Intervenors: Department of Defense and Graves Answering Phone Service et al.

Docket No. U-6493

Tennessee Public Service Commission

December 30, 1977

Before Robert N. Clement, chairman (dissenting in part), and Z. D. Atkins (dissenting in part), and Frank D. Cochran, commissioners.

By the COMMISSION:

Order

This matter is before the Tennessee Public Service Commission upon a petition filed on July 1, 1977, by South Central Bell Telephone Company (hereinafter referred to as South Central Bell or company), requesting authority to increase its existing rates and charges for intrastate telephone service to produce an annual increase in revenue of approximately $92 million. Chairman Robert N. Clement and Commissioners Z. D. Atkins and Frank D. Cochran heard the matters presented in this proceeding. The commission issued an order on August 22, 1977, permitting the intervention of the Secretary of Defense and permitted the intervention of Graves Answering Phone Service, Inc.; Answering Service, Inc.; Deadrick and Sandford, Inc.; AAA Answering Service, Inc.; and WUI/TAS, Inc., by bench ruling on October 19, 1977.

Service hearings were held at Knoxville on September 26th; Morristown on September 27th; Chattanooga on September 28th; Columbia on October 11th; Murfreesboro on October 12th; Jackson on October 13th; and Memphis on October 13th, at which time testimony was received from public witnesses concerning the company's proposed directory assistance repricing plan (DAR plan) and the company's request to increase coin-telephone rates to 25 cents, as well as other areas concerning service. Hearings on the financial aspects of the company's request were held in Nashville on October 18th through October 20th, and November 22nd and 23rd. During the hearings held in Nashville, the following appearances were entered:

APPEARANCES: Raymond Whiteaker, Jr., General Counsel, South Central Bell Telephone Company, Nashville, and Robert Sutherland, Attorney, South Central Bell Telephone Company, Birmingham, all appearing for the petitioner, South Central Bell; Paul R. Schwedler, Attorney, Department of Defense, Department of the Army, Judge Advocate General (DAJA-RL), The Pentagon, Washington, D. C., appearing on behalf of the Department of Defense and all executive agencies of the United States government, intervenors; William Waller, Jr., Attorney, American Trust Building, Nashville, and Dennis K. Muncy, Attorney, Champaigne, Illinois, all appearing on behalf of Graves Answering Phone Service et al., intervenors; Thomas E. Midyett, Jr., Assistant General Counsel, Tennessee Public Service Commission, appearing on behalf of the commission staff and the citizens and residents of the state of Tennessee, as their interests may appear.

The company submitted the prepared testimony of the following seven witnesses when the petition and tariffs were filed on July 1, 1977: V. E. New, vice president of operations in Tennessee; D. M. Ballard, assistant to the chief accountant, South Central Bell Telephone Company; William T. Fray, Jr., assistant to the vice president of Tennessee operations; Richard M. Wolf, engineering manager--price comparison methods, American Telephone and Telegraph Company; Thomas F. Clifford, assistant manager of public statistics in the regulatory matters division, Western Electric Company; Graham K. Ragland, manager--license contract and regulatory matters, American Telephone and Telegraph Company; and William R. Meredith, assistant vice president in the revenue requirements department, South Central Bell Telephone Company. Mr. Ragland was unable to testify at the hearings, and his testimony was adopted by Richard E. Stark, supervisor--license contract and regulatory matters, American Telephone and Telegraph Company. The company also presented testimony through E. Q. Faust, assistant vice president--revenue requirements department, South Central Bell Telephone Company, and James H. Anderson, district staff manager-- rates, South Central Bell Telephone Company. Cross-examination of the company's

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witnesses began on October 18th, continuing through October 20th, and concluding on November 22nd.

All prepared testimony of other parties, including the commission's staff, was filed with the commission on November 7, 1977, to allow the company sufficient time to study the testimony and to go forward with its cross-examination at the continued hearings on November 22nd and 23rd.

At the continued hearings on November 22nd and 23rd, testimony on behalf of the answering service intervenors was presented by: Carolyn Cantrell, partner-- Coffee County Answering Service; Evelyn Zellner, operator--Murfreesboro Professional Business Exchange; Elliot Singer, owner--AAA Answering Services, Inc.; and Richard V. McNamara, vice president--Answering Service, Inc. Testimony was also presented by Jack Baccari, research director for District 10 of the Communications Workers of America. Testimony on behalf of the Department of Defense (DOD) was presented by Woodrow E. Dooley, staff accountant and accounting advisor, regulatory law office, Office of the Judge Advocate General, Department of the Army. Testimony on behalf of the commission staff was presented by Whitfield Burcham, director of the accounting division, and Dwight S. Work, assistant director of the accounting division. The company cross-examined each of these witnesses and presented evidence in rebuttal of the answering service witnesses through Mr. Fray; in rebuttal of Mr. Baccari through Mr. New; in rebuttal of Mr. Dooley through Mr. Ballard; and in rebuttal of Mr. Work through Mr. Ballard and Mr. New.

The company and the commission staff entered into an agreement that it was not necessary to introduce new testimony and exhibits into the record concerning rate of return and capital structure issues. Because of the short lapse of time between the commission's decision of May 4, 1977, Docket No. U-6402, the last general rate case involving this company, and the company's filing in the instant case on July 1, 1977, it was felt by both the company and the staff that there had been no changes during this period that would materially affect the record made on these issues in Docket No. U-6402. Therefore, the direct testimony, cross-examination rebuttal, surrebuttal, and exhibits constituting the record in Docket No. U-6402 of the company's witnesses, Mr. Faust and Eugene W. Meyer, investment banker, Kidder Peabody & Co., Inc., and the staff's witness, David A. Kosh, president of David A. Kosh and Associates, Inc., was entered along with the stipulation as Exhibit 8 in this record.

Corporate Structure

South Central Bell Telephone Company is one of 24 operating companies included in the American Telephone and Telegraph Company (AT&T) Bell system. One hundred per cent of the outstanding capital stock of South Central Bell is owned by AT&T. The Bell system includes Bell Telephone Laboratories, Inc., and Western Electric Company. Bell Labs performs research, development, and design work; and Western Electric manufactures, purchases, repairs, and distributes apparatus, equipment, and supplies, and installs central office equipment for the Bell system. The AT&T Long Lines Department operates long-distance interstate lines, and the AT&T general department provides services to the operating Bell telephone companies under license contracts and provides similar services to the Long Lines Department. South Central Bell serves five states including Tennessee. The company's service area in Tennessee covers both intrastate and interstate business. However, the proceeding herein is concerned only with South Central Bell's Tennessee intrastate operations.

Criteria for Establishing Just and Reasonable Rates

This commission is charged under TCA 65-520 with the responsibility of setting just and reasonable rates for the company to charge its customers in the state of Tennessee. In the past, the standard we have followed to meet this statutory obligation has been to select a test period (usually one year) and make the following four basic determinations: (1) upon what investment (rate base) should the utility be permitted to earn a fair rate of return, (2) what level of revenues should be used, (3) what level of expenses should be used, and (4) what rate of return should the utility earn? We will continue this policy and will analyze and discuss the reasoning advanced by all parties concerning the test period and the four basic questions mentioned above and will make a finding on each. Once a decision is reached on these matters, we are then able to determine whether the rates filed are just and reasonable.

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Test Period

Test period is a term peculiar to regulation. In general, it is a 12-month period of time; however, the concept of test period embodies more than just the selection of a 12-month period, but also includes the basic question of how this 12-month period of time should be presented. A test period may be entirely historical, entirely forecasted, or a combination of the two. Once the 12-month period is selected, a decision must be made as to whether an average or an end-of-year test period should be used, and whether the average or end-of-year test period should be adjusted to include the effects for the entire year of known changes in rates. The decisions that are made concerning the test period determine the approach that will be followed in the development of the basic amounts shown on the rate base and income statement schedules.

The object of a test period is to develop revenues, expenses, and rate base items which are representative for the purpose of testing the company's earnings under the existing rate structure. This objective is accomplished by selecting a 12-month period of time, analyzing the actual or forecasted results of operations, and making whatever adjustments are necessary to develop a proper relationship of revenues and expenses to investment. Once this objective has been accomplished and a fair rate of return determination has been made, a decision can then be rendered on the rates that are necessary to produce what we have determined to be a fair rate of return. This has been the basic regulatory process that we have followed in testing the reasonableness of utility rates, and we will not deviate from this philosophy in this case.

In this case, the company has based its rate increase request on the forecasted test period for the twelve months ending December 31, 1978, adjusted to include the annual effect of the August, 1978, salary and wage increases. Only five months' effect of these anticipated salary and wage increases are included in the basic financial forecast for the twelve months ending December 31, 1978. It is the company's position that since these increases are known changes in rates (salary and wage rates) and will continue into 1979, that revenues based on the basic financial forecast for 1978 will automatically fall short of covering known expenses in 1979. The company argues that, because of the certainty of the increase, rates should be set to cover the annual effects of the salary and wage increases so as to forestall the erosion of the rate of return that this commission ultimately grants. The company also presented, as supplemental information, an historical test year for the twelve months ended March 31, 1977.

The commission staff also recommended the use of the forecasted test period for the twelve months ending December 31, 1978. However, the staff did not adjust its forecast for the annualization of the August, 1978, salary and wage increases. The staff took the position that, assuming the commission granted the company an increase in rates and assuming a reasonably accurate forecast, these increased rates would be in effect for the entire test period and would, therefore, afford the company every opportunity to earn within a reasonable range of the rate of return ultimately approved by this commission. The staff felt that it is the company's responsibility through cost controls, increased sales efforts, new technology, and increased productivity to attempt to extend the time period to encompass a greater than 12-month period.

The DOD witness, Mr. Dooley, recommended the use of an historical test year, twelve months ended July 31, 1977. He adjusted his test period for the annual effect of known changes occurring within his 12-month period and then adjusted his test period to an end-of-period level. He then adjusted his test period again for the effect on 1978 operations of his classification of known changes occurring from August 1, 1977, through December 31, 1978. It was Mr. Dooley's contention that using actual results and adjusting those results for known changes was more reliable than attempting to forecast into the future. The commission feels that Mr. Dooley's concept is one of several acceptable approaches in developing a test period. However, the record is replete with possible errors in Mr. Dooley's methodology used to develop his concept. We are sorry that Mr. Dooley's schedule was such that he was unable to stay and cross-examine and/or surrebut company witness Ballard's rebuttal of his testimony. Mr. Ballard's rebuttal testimony and exhibits contain evidence that Mr. Dooley committed material errors in developing his test period and, because of the circumstances, are unchallenged. In our opinion, the most glaring potential error is that Mr. Dooley adjusted revenues due to growth in total telephones but did not adjust expenses due to the same growth. We feel that it is inconsistent to assume that increased volumes of telephones will increase revenues but not expenses.

Before this commission comments specifically on our decision concerning the appropriate test period to use, we would like to express, in generalities, some of our feelings in regard to the use of a forecasted test period and in so doing answer some of Mr. New's criticism concerning past commission actions. The obvious advantage to a utility of using a forecasted test period, assuming of course that the forecast is reasonably reliable, is that it helps to overcome regulatory lag, and, for some companies, helps them achieve the returns authorized where expenses increase at a faster pace than revenue and productivity

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gains. When we first adopted a forecasted test period for a major utility, we also assumed that another advantage, to everybody, would be a decrease in the frequency of rate filings. This advantage has never materialized, and in fact the converse seems to have occurred. Quite frankly, we have been extremely disappointed. Our disappointment and concern does not stop there, however. We are concerned that we may have inadvertently put aside the only tool at our disposal usable in increasing management's incentive to control costs, etc., so as to earn within a range of the rate of return that we have authorized. It is our fear that as soon as a company can look into the future after a rate order and put together twelve months in which the forecasted rate of return is less than the rate of return we granted, then they will file for another rate increase. Even if this fear is exaggerated, any occurrence proximate to our concern destroys the concept of regulation. We, as regulators, must not only afford the company an opportunity to earn a reasonable rate of return on its rate base, but we must be the substitute for competition and make sure that a company is operating as efficiently as possible if, by using a forecasted test period, it seeks a rate increase as soon as there is the slightest indication that its rate of return is eroding. As we have stated in other orders, and this one will be no exception, when we grant a rate of return we are not guaranteeing that a company will earn that rate of return, and we are not bound by law to make this guaranty. We are only bound to give the company a reasonable opportunity to earn our authorized rate of return.

In our last order we adopted for the first time a forecasted test year for South Central Bell. We expressed reservations about adopting the forecasted test year and indicated that this would not necessarily be a precedent for future cases, and that we would reevaluate our position and look at the individual facts surrounding any future case coming before the commission. As we have stated, our concern now is that by adopting a forecasted test year we have eliminated the only tool at our disposal to motivate management to control cost and operate efficiently. It seems to us that rather than management striving to earn a fair rate of return by holding the line on its rapidly growing costs, their attitude is to simply refile with this commission for more rates. We must not lose sight of the fact that South Central Bell is a monopoly, and we, as regulators, must act as the substitute for competition. We do not think we can fulfill that role by adopting a forecasted test year in this case which will effectively guarantee South Central Bell a rate of return.

We will now turn our discussion to some of the very real practical problems with using the forecast proposed by the company. First of all, the forecast is merely a trend of past experience adjusted for someone's best judgment. This type of information does not lend itself to being rigorously examined or tested by the commission. To illustrate the degree of speculation, we would like to discuss a few items of cost forecasted by South Central for 1978 that they are asking us to approve for the customers to pay.

(1) An expected increase in depreciation rates due to represcription totaling $7,105,000. The commission staff, along with the staff of the other four states where South Central operates, and the FCC staff will study these rates sometime during 1978 and make recommendations to the commission which we, as well as the FCC, must approve, modify, or reject. So there is a great deal of speculation on the inclusion of this item. It may even be said that to set rates to cover this is to prejudge this issue before it is formally brought before us.

(2) An expected increase in depreciation expense of $1,415,000 due to an expected change in the method of computing depreciation (ELG). This must be approved by the FCC. We would also note that the company has sought to include this item in the past two major rate cases on the same basis, and to this date it is yet to be approved by the FCC.

(3) The company went so far as to include in its forecast of expense an expected increase in postage from 13 cents to 15 cents on July 1, 1978. This may or may not occur. We believe that there is a stronger probability there will be a corporate federal income tax reduction than there will be a postage increase in 1978, which the company has not anticipated in its forecast.

(4) During the course of the hearings, the company revised downward its original forecast of wages. Exhibit 3, staff oral request (October 19, 1977), Sheet 2, indicates that the company revised its 1978 wage forecast downward by $1,433,000 on a combined basis.

(5) Staff indicated in its testimony that the company, in developing its forecast of federal income tax expense, overstated it by $908,000 because of the company's failure to amortize investment credit properly.

(6) In computing the forecasted revenue requirements, the company understated the accumulated deferred income tax by $11,595,000 which it claimed was required because of an IRS limitation when a forecasted test year was used. The staff

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indicated that it did not interpret the code to place that limitation upon the company.

We think these facts indicate that there is a lot of speculation in the use of a forecast, and that the company has been very liberal in anticipating expense increases. For example, suppose we increase the customers' phone bills by $7,105,000 to cover the company's anticipated increase in depreciation rates totaling $7,105,000 and the depreciation rates are not ultimately approved. The customers will pay $7,105,000 in higher phone bills even though the company does not incur the expenses--clearly a windfall profit.

After considering all these factors, it is our firm conviction that the commission should use the historical test year filed by the company for the twelve months ended March 31, 1977, to evaluate the current level of earnings under the existing rates. Unlike a forecast, these financial data can be verified from the company's books and records. However, we do feel that we should adjust the revenues and expenses for all known changes that have occurred through December 31, 1977. We believe this will make adequate allowance for attrition caused by cost increases.

In testing the representativeness of the historical revenues and expenses, we have reviewed the company's actual rate of return experience subsequent to our approval of a $25.8 million rate increase in May of this year. The information we have available for May through September shows that South Central Bell has actually earned a rate of return of 9.4 per cent. There is one other significant observation to take note of, and that is the company's own forecast for the first six months of 1978. The company is forecasting its rate of return to be about 8.3 per cent for this period. By adjusting the company's forecasted rate of return for this six-month period to correct for the $908,000 federal income tax error, to eliminate the $1,415,000 increase in depreciation expense due to ELG, to correct for the overstated wage estimate amounting to $1,433,000 on a combined basis (approximately 70 per cent or one million dollars to intrastate operations), and to use the actual accumulated deferred income tax, the company's forecast would indicate a rate of return of 8.6 per cent.

As an example of the fear that we discussed on page 286 of this order, *supra*, we cite the following example. On May 4th, in our order in Docket No. U-6402, we set the rate of return for this company at 9.10 per cent. We discussed in that order that a fair rate of return is not a precise number but could be a little more or a little less and remain in the zone of reasonableness. Using the actual rate of return for May through September of 1977, the company's forecast of the rate of return for each month, October through December of 1977, found in Exhibit 3, and the rate of return for the first six months of 1978 that we developed in the previous paragraph, it appears that the rates that we set in our May 4th order will produce an average rate of return of approximately 8.80 per cent for the 14-month period, May, 1977, through June, 1978. This 8.80 per cent easily falls within the zone of reasonableness that was contemplated in the May 4th order. This is an excellent example of our concern regarding the use of a forecasted test period and is one of the primary reasons we are turning back to the use of an historical test period for the purpose of setting rates in this case.

We, therefore, will adopt the historical test year, adjusted to an end-of-year basis, for the twelve months ended March 31, 1977, and adjusted for all known changes occurring through December 31, 1977.

Rate Base

We will now turn our attention to the issue of determining the proper rate base on which the company should be allowed the opportunity to earn a fair rate of return. The company defined its rate base as the net investment used and useful in providing utility service. The company's rate base was computed by including telephone plant in service, telephone plant under construction, property held for future telephone use, materials and supplies, and cash as additions in its calculations and then deducting depreciation reserve from the sum of the additions. Company witness Ballard used, in his determination of net investment, only those balance sheet accounts which he classified as physically used and useful in the provision of telephone service. The company contends that it should be allowed to earn on its net investment that is used and useful in providing telephone service, no matter who finances that investment.

Department of Defense witness Dooley developed his rate base by including as additions, telephone plant in service, telephone plant under construction, property held for future telephone use, materials and supplies, and cash, and by including as deductions depreciation reserve, customer deposits, unamortized investment tax credit--pre-JDIC, accumulated deferred income tax, unpaid for materials and supplies, unpaid for plant in service, and unpaid for plant under construction. Mr.

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Dooley contends that the company should be allowed to earn a return only on its net investment that is supplied by the debt and equity investor.

Staff witness Work developed his rate base by including as additions telephone plant in service, telephone plant under construction, property held for future telephone use, materials and supplies, and cash, and by including as deductions depreciation reserve, unpaid for portion of materials and supplies, cash advanced through operations, accumulated deferred income tax, unamortized investment tax credit--pre-JDIC, and customer deposits. Mr. Work followed the principle that a regulated utility should be given the opportunity to earn a fair rate of return on its equity investment that is financed by debt and equity investors. Mr. Work contends that a utility should not be allowed to earn on the portion of its investment that is not financed by debt and equity investors.

We will now discuss each rate base component listed in the presentations of the three witnesses. Our discussion will be limited to differences due to divergent principles of developing rate base and differences due to specific adjustments. Our discussion will not involve any differences caused by test period variances, an issue that we have previously decided.

Telephone Plant in Service

There was no disagreement among the three witnesses concerning the development of telephone plant in service. Therefore, consistent with our decision on test period, we will include $1,194,665,000 in telephone plant in service in our rate base calculation.

Telephone Plant under Construction

There was no difference among the three witnesses concerning the development of telephone plant under construction. In keeping with our adoption of an historical test period we will include $39,961,000 in telephone plant under construction in our calculation of rate base.

Property Held for Future Telephone Use

There was no difference between the company witness and the staff witness concerning the amount of property held for future telephone use to be included as an addition in the development of rate base. Department of Defense witness Dooley proposed to reduce this item and contended that the company should not be allowed to earn on property that it has held for longer than six years. He states that to ask customers to pay a return on property held in excess of six years is unfair and unreasonable.

This commission, in the absence of proof showing bad judgment on the part of management, has traditionally allowed companies under its jurisdiction to earn a return on the entire amount of its property held for future use. This procedure has been followed to allow a return on the capital, debt and/or equity, utilized to purchase this property. In the absence of evidence to the contrary, this commission must assume that management's actions to purchase this property were proper and ultimately will result in cost savings to the customer. There is no evidence in this record which indicates that management's actions were improper. We will, therefore, not accept Mr. Dooley's adjustment to property held for future telephone use. We will include $777,000 in property held for future use in our calculation of rate base.

Materials and Supplies

There was no disagreement among the three witnesses concerning the development of materials and supplies. Therefore, consistent with our adoption of an historical test period, we will include $14,220,000 in materials and supplies in our rate base calculation.

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Cash Requirements

There was no disagreement between company witness Ballard and staff witness Work as to the amount of cash requirements to be included as an addition in their computation of rate base. Department of Defense witness Dooley proposed to reduce cash requirements by the amount used as compensating bank balances. Mr. Dooley argued that the company should be allowed a return only on that part of the cash requirement that is considered as working funds.

Compensatory bank balances are maintained to minimize bank service charges. This commission is of the opinion that this policy is in the customer's best interest because it holds down costs that would otherwise be passed on to the customer. We deny Mr. Dooley's adjustment to decrease the amount of cash requirements to be included as an addition in developing rate base. We will include $1,405,000 in cash requirements as an addition in calculating rate base.

Depreciation Reserve

There was no disagreement among the three witnesses concerning the principles of developing depreciation reserve. Therefore, consistent with our adoption of an historical test period, we include $224,391,000 as a deduction in calculating rate base.

Unpaid for Portion of Materials and Supplies

Company witness Ballard did not include unpaid for portion of materials and supplies as a deduction in arriving at rate base. The company contends that these materials and supplies are a part of its investment in property used and useful, and that, therefore, they should be allowed to earn a return on them.

Both DOD witness Dooley and staff witness Work included this item as a deduction in their respective calculations of rate base. Mr. Dooley contends that this item represents amounts supplied by creditors and that the company should not be permitted to earn a return on items that are supplied by noninvestors. Mr. Work's argument is comparable to Mr. Dooley's. He states that the unpaid for portion of materials and supplies represents that portion of the materials and supplies balance that will remain as accounts payable during the test period. Of course, this means that if this item is an accounts payable, the investors have not supplied capital to pay for this unpaid for balance. Since the investor has not had to supply capital, then he should not receive a return on the investment that he has not financed.

This commission agrees with the arguments advanced by the staff and DOD. It is our position that investors should not receive a return on the company's investment that they have not financed. To do so would allow the utility to earn a return on noninvestor-supplied funds with the resultant effect that the utility would earn a greater return on equity than is implicit in the overall rate of return determination. We, therefore, include $8,125,000 of unpaid for materials and supplies as a deduction in calculating rate base.

Cash Advanced through Operations

Neither the company nor DOD included cash advanced through operations as a deduction in computing rate base. Department of Defense witness Dooley did not specifically comment about this item during the hearing. Company witness Ballard testified on rebuttal that any considerations of the source of funds should be included as a function of rate of return and not rate base. He stated that the items in rate base should come from the books of accounts as prescribed by the Uniform System of Accounts which would make the presentation of rate base more orderly.

Staff witness Work deducted, in calculating rate base, cash advanced through operations which was developed through the

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use of a lead-lag study. Mr. Work stated that this represents cash advanced by the customers for payment of their telephone bills in advance of the company's payment of expenses. He concluded that this was another source of noninvestor-supplied funds which have been used to finance a portion of the company's investment in property used and useful.

Again, we agree with Mr. Work's conclusions on this point. This item does represent a source of noninvestor-supplied funds that can be used to finance plant and working capital requirements. It is the commission's position that the company should not receive a return on that portion of its investment that has been financed through noninvestor-supplied funds. We will include as a deduction in calculating rate base $12,997,000 in cash advanced through operations.

Accumulated Deferred Income Tax

Company witness Ballard did not include accumulated deferred income taxes as a deduction in his development of rate base. Mr. Ballard developed his net investment by adding the cost of the physical assets recorded on the books of the company. Then Mr. Faust took Mr. Ballard's net investment figure and multiplied it by his recommended 11 per cent fair rate of return to come up with 'income requirement for fair rate of return.' Mr. Faust then reduced the 'income requirement for the fair rate of return' by the sum of the amounts derived from multiplying the 11 per cent by the accumulated deferred income tax and the unamortized investment tax credit to arrive at the income that the revised tariffs should produce. The result of this procedure is identical to the result that would be reached if the accumulated deferred income tax and the unamortized investment tax credit were deducted in arriving at rate base. The apparent significance of the company's treatment of the deferrals in this manner rather than deducting them in arriving at rate base is to preserve its claim that it is legally entitled to earn a return on the net investment figure developed by Mr. Ballard, regardless of who supplied the funds to finance this net investment.

Department of Defense witness Dooley deducted accumulated deferred income tax in computing rate base. He stated that the amount in this account represented noninvestor-supplied funds that had been used to finance a portion of the company's net investment. It was his opinion that the company should not earn a return on its investment that had been financed through noninvestor-supplied funds.

Staff witness Work included accumulated deferred income taxes as a deduction in his calculation of rate base. He stated that this balance represents the end result of normalizing the tax effects of the difference in book depreciation expense and tax depreciation expense. This normalization results in showing an income tax expense in the income statement that has not actually been paid and a resultant tax liability in the accumulated deferred income tax account on the balance sheet. Mr. Work therefore contends that the ratepayer has had included in his telephone rate an expense which is deferred for payment until a later date, and the company has used this capital to finance a portion of its net investment. The deferral of payment is shown in the accumulated deferred income tax account which represents noninvestor-supplied funds that should be deducted in arriving at rate base.

We agree with the principle that the rate base should represent the investment financed by debt and equity investors and will, therefore, adopt the recommendation that accumulated deferred income tax be included as a deduction in arriving at rate base. In keeping with our test period determination, we will include $83,784,000 as a deduction in calculating rate base.

Unamortized Investment Tax Credit--Pre-JDIC

Company witness Ballard did not include unamortized investment tax credit-- pre-JDIC as a deduction in arriving at rate base. However, the company does reduce its income requirement for this item, which has the same effect on income requirement as the method proposed by the staff and by DOD.

Department of Defense witness Dooley did include this item as a deduction in computing rate base. Mr. Dooley contends that this balance represents a source of noninvestor-supplied funds used to finance a portion of the company's investment. Mr. Dooley argues that the company should not be allowed to earn a return on its investment that is financed by noninvestor-supplied funds.

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Staff witness Work also included this item as a deduction in arriving at rate base. Mr. Work stated that this account represented the unamortized balance of investment tax credit generated under the 1962 tax act. He argued that this balance represents noninvestor-supplied capital which was used to finance a portion of the company's investment and, therefore, should be deducted in computing rate base.

Again, the commission agrees with the principle that the rate base should represent the investment financed by debt and equity investors. We will adopt the recommendation that unamortized investment tax credit--pre-JDIC should be included as a deduction in arriving at rate base. Based on our adopted test period, we will include $3,799,000 as a deduction in calculating rate base.

Customer Deposits

Company witness Ballard did not include customer deposits as a deduction in arriving at rate base. Mr. Ballard has stated that all considerations relating to source of funds should be considered as a function of rate of return and not rate base.

Department of Defense witness Dooley did include this item as a deduction in computing rate base. Mr. Dooley testified that customer deposits were noninvestor-supplied funds that had been used to finance a portion of this company's investment. Following his principle of rate base development, the company should not be allowed a return on that portion of its investment financed by noninvestor-supplied funds. He also proposed to treat the interest accrued on these deposits as an operating expense.

Staff witness Work also included this item as a deduction in arriving at rate base and also included the interest on these deposits as an operating expense. He stated that this account includes deposits paid to the company by customers for the privilege of being able to obtain telephone service. This account represents noninvestor-supplied funds that the company has had available to finance a portion of its net investment and should, therefore, be deducted in computing rate base.

Once again, this commission agrees with the principle that the rate base should represent the company's net investment financed by debt and equity investors. Therefore, we adopt the recommendation that customer deposits should be included as a deduction in arriving at rate base, as well as the recommendation that the interest accrued on these deposits be included as an operating expense. We will include $4,519,000 as a deduction in arriving at rate base.

Unpaid for Telephone Plant in Service and Unpaid for Telephone Plant under Construction

Neither the company nor the staff included unpaid for telephone plant in service and unpaid for telephone plant under construction as deductions in arriving at rate base.

Department of Defense witness Dooley, however, did include these two items as deductions in computing rate base. He contended that since these two items are accounts payable, the investor has not yet supplied the funds to finance the portion of plant in service and plant under construction represented by these two balances. Since the portion of plant in service and plant under construction represented by these two balances has been financed by noninvestors, the company should not be allowed a return on these unpaid for balances.

The commission feels that Mr. Dooley's arguments have merit. In fact, this has been discussed by staff witnesses in prior cases involving this company. We are aware, however, that these two items are a part of a working capital study which is also composed of cash requirements, cash advanced through operations, materials and supplies, and unpaid for portion of materials and supplies. We are also cognizant of the fact that there may be other items, both investor supplied and noninvestor supplied, which should be considered in any detailed working capital study if one is also going to consider unpaid for plant in service and unpaid for plant under construction. Neither company, the staff, nor Mr. Dooley have performed such a study. Because of this fact we are very reluctant and, in fact, will not change the working capital portion of the rate base formula that this commission has developed over the years until we are reasonably sure that all items properly relating to working capital have been considered. We charge both the company and the staff to make every effort to develop a

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working capital study which gives proper consideration to all components, whether they be investor supplied or noninvestor supplied.

In summary, we adopt the staff's principles of developing a rate base. This commission feels that we summarized our philosophy of developing a rate base quite well in the order in Docket No. U-6402, and we will repeat those remarks here. When we assign a rate of return to a rate base, that rate of return is composed of the weighted costs that will allow the company to pay a return to its investors in debt, preferred stock, and common equity. That is what a rate of return is, no more, no less. If we assign a rate of return to a rate base that is composed of investment that has been supplied by someone other than the debt and equity investor, then the company will have available to it a return greater than the return explicitly prescribed for the debt investor, the preferred stock investor, and the common equity investor through the rate of return. Where does this additional return go? Since the debt investor and the preferred stock investor receive their return through a set contract, which is a portion of the composition of rate of return, then it follows that the additional return flows through to the common equity investor either through dividends or retention by the company in retained earnings. It is our feeling that the company does not disagree with this opinion. It is the company's position that net investment or rate base should be left alone, and that the question of source of funds should be dealt with in the rate of return determination. However, as our discussion has indicated, we disagree with this position. We feel that a rate base should represent the investment in property used and useful on which a company should be allowed the opportunity to earn a fair rate of return. We also believe, and believe strongly, that a company should be allowed the opportunity to earn a fair rate of return only on its investment that is financed by debt and equity investors. Thus, our definition of a rate base is the investment in rpoperty used and useful, financed by debt and equity investors, on which a utility should be allowed the opportunity to earn a fair rate of return.

Therefore, the commission adopts the rate base of $913,413,000 reflected on the following schedule as being the proper investment on which the company should be allowed the opportunity to earn a fair rate of return.

SOUTH CENTRAL BELL TELEPHONE COMPANY

TENNESSEE INTRASTATE RATE BASE

AS OF MARCH 31, 1977

'000' OMITTED

Line No.		
1	Telephone plant in service	$1,194,665
2	Telephone plant under construction	39,961
3	Property held for future telephone use	777
4	Materials and supplies	14,220
5	Cash requirements	1,405

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6	Total (L1 through L5)	$1,251,028
7	Depreciation reserve	$224,391
8	Unpaid for portion of materials and supplies	8,125
9	Cash advanced through operations	12,997
10	Accumulated deferred income tax	83,784
11	Unamortized investment tax credit--pre-JDIC	3,799
12	Customer deposits	4,519
13	Total (L7 through L12)	$337,615
14	Rate base (L6 - L13)	$913,413

Source: Lines 1 through 7: Ballard Exhibit 6, Part 3. Lines 8 through 11: Exhibit 7. Line 12: $5,869 (Exhibit 3, Item 2, Sheet 2) x 77% (Exhibit 23, DSW-1, Schedule 2-4).

Revenues and Expenses

As we have stated previously, both the company and the staff based their respective cases on a forecasted test period for the twelve months ending December 31, 1978. The DOD witness presented an historical test period for the twelve months ended July 31, 1977, adjusted for known changes within the test period as well as known changes outside the test period through December 31, 1978. Since we have previously rejected a forecasted test period and adopted the historical test-year data presented by the company for the twelve months ended March 31, 1977, our discussion will be devoted to the recorded results for this period of time and the necessary adjustments thereto. Since DOD's witness, staff witness, and company witness' discussion related in some cases to different periods of time, our discussion will be limited to the principle underlying the adjustment and our findings related thereto.

Federal Income Tax Savings Adjustment

Both staff witness Work and DOD witness Dolley proposed an ajdustment to decrease federal income taxes recorded on the books of South Central to recognize the consolidated Bell system tax savings effect of interest related to Tennessee intrastate operations which is not shown on South Central Bell's books. Staff's method is identical to the approach followed by the commission in past cases, and this method has been repeatedly upheld by the courts of this state. Company witness Ballard stated on rebuttal that he disagreed with the concept of the adjustment and specifically criticized the methodology used by

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DOD witness Dooley to compute his adjustment. Department of Defense's witness attempted to develop an investor-supplied rate base to determine the company's revenue deficiency but, instead of using this rate base to compute the federal income tax adjustment, he used the company's calculation of rate base which includes noninvestor-supplied items of capital.

It is obvious to this commission that the method used by DOD's witness is incorrect. The theory behind the adjustment is that debt capital at both the parent (AT&T) and subsidiary levels has been invested in the investor-supplied assets of South Central Bell. The investor-supplied assets of South Central Bell are those assets as denoted in a development of rate base as defined by this commission. It is inconsistent to use one rate base, developed similar to this commission's definition, to compute revenue deficiency while using a larger rate base, which includes noninvestor-supplied items, to compute a federal income tax adjustment.

We feel that the staff's procedure properly recognizes the economic realities of the parent-subsidiary relationship. The economic realities are the the Bell system files a consolidated federal income tax return. The interest expense deduction shown on the consolidated return is based on the consolidated debt of the Bell system. The components of this consolidated debt the the debt of the operating companies, the debt of the other subsidiaies, and the debt of the parent. The debt of the parent is used to finance a portion of the investment of all of its subsidiaries, South Central Bell being one of those. Since a portion of AT&T company debt is significantly related to the equity investment of South Central Bell, the ratepayers of South Central Bell should receive the benefits of the additional interest related to this debt. Therefore, we adopt the staff's recommendation to adjust the federal income tax recorded on the company's books for the interest expense shown on AT&T's books which is related to South Central Bell's Tennessee intrastate investment. The amount of the federal income tax savings based on staff's methodology is $664,000 for the March 31, 1977, test year, and we will use this in developing the March 31, 1977, test-year expenses and net operating income.

Lobbying Expense

Staff witness Work proposed an adjustment to general expense to eliminate for rate-making purposes expenditures made by the company in connection with its lobbying activities involving members of the state legislature. Mr. Work stated that the customers should not have to pay through their rates for a lobbyist to act as an intermediary between them and their elected representatives.

The company brought out on cross-examination that lobbying expense as defined in Mr. Work's adjustment was not classified as lobbying expense by the Public Acts of 1975. Mr. Work responded that the purpose of this act was not to define lobbying expense for regulatory purposes, but, instead, to define lobbying expense reportable to the Tennessee State Library and Archives. The company insisted that the activities of its lobbyist were primarily for informational purposes instead of for the purpose of influencing legislation. The company argued that the legislation in which it was interested was of direct benefit to the company and, therefore, had to be of benefit to the customers.

Mr. Work stated that the customer was a better judge of what benefited him because not all legislation that the company favored was beneficial to the customer. He gave as a prime example of legislation beneficial to the company but of detriment to the customer the treatment required by Congress of JDIC. Staff witness Burcham also testified that the required treatment of JDIC was of no benefit to the general customer.

Mr. New stated on rebuttal that he felt Mr. Work was inconsistent by asking the company to control expenses on the one hand while asserting on the other hand that the company should not determine the impact on its operations of every piece of legislation. Mr. New opined that lobbying expense was a legitimate business expenditure that should be passed on to the customers through their rates.

This commission has in past cases involving this company adopted the adjustment for lobbying expense. We still believe that the first obligation of the company's lobbyist is to act in a manner that is beneficial to the company, which may or may not be beneficial to the company's customers. We will continue our position that this is an improper expense for rate-making purposes. For the March 31, 1977, test year, the effect on net operating income of disallowing this amount is $2,000.

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Local Service Revenue Adjustment

Both the staff witness and the DOD witness adjusted local service revenue to impute revenue to the company as though the management personnel receiving 100 per cent concessions were receiving 40 per cent, which is the concession allowed nonmanagement level employees. The company did not include this revenue in the development of its case. We have adopted this adjustment in the past, and we will do so again in this case. We still find no reason to treat management employees any differently than nonmanagement employees are treated. The effect on net operating income of this adjustment is $92,000.

Interest on Customer Deposits

Staff witness Work and DOD witness Dooley both recommended that interest on customer deposits be included as an above-the-line expense consistent with their recommended deduction of customer deposits in the calculation of rate base. Since this commission has adopted the principle of deducting customer deposits in the calculation of rate base, we will also treat interest accrued on those deposits as an operating expense for rate-making purposes. Interest on customer deposits amounts to $271,000 (6 per cent x $4,519,000) for the March, 1977, test year. The aftertax effect on net operating income is $141,000 [$271,000 x (1.00 - .48)].

Toll Service Revenue Adjustment

Staff witness Work proposed an adjustment to increase toll service revenue by an amount equivalent to the revenue lost by the company due to its policy allowing employees to make a certain amount of long-distance calls free of charge. Neither the company witness nor the DOD witness included this revenue in the development of their respective cases.

Mr. Work supported his adjustment by stating that there was no justification in asking ratepayers to pay through their rates for the company employees' free long-distance calls. He stated that the company's decision to allow its employees to make a certain amount of free long-distance calls had no relationship to the quality of service that was provided by the company. It was his opinion that the company should be allowed only the reasonable expenses that were directly related to the company's purpose, that being the provision of telephone service.

The company argued through cross-examination that the allowance of free long-distance calls was simply another fringe benefit received by employees who generally made the calls during nonpeak hours in the evening. They stated that if this benefit was disallowed, it might be an object of collective bargaining in the future and could end up costing the company more in additional benefits than does the present company policy. The company also indicated that this policy had been a practice of telephone companies for many years, and that it is permitted by the Communications Act of 1934. The company questioned how Mr. Work could distinguish between this fringe benefit and other fringe benefits such as insurance or vacations.

Mr. Work responded that he felt ratepayers understood that to receive service they must pay through their rates for competitive salaries and wages and fringe benefits such as hospitalization insurance, vacations, dental plans, etc. He felt that the facts showed that the company's employees were earning fair salaries and wages and that their standard fringe benefits were also fair. In his opinion, the compensation was attractive enough, without the extra benefit of free long-distance calls, that the company would have no problem attracting prospective employees. He felt that the standard employee compensation was a necessary expense on the part of the company in providing telephone service, but that allowing employees to make free long-distance calls in the evening had no relationship to the type or quality of service offered by the company. He indicated that he was not objecting to the policy of allowing free long-distance calls, but, since it was a company policy, it should be the stockholders who paid for this benefit instead of the ratepayers. In response to other points raised by the company, Mr. Work noted that Mr. New had stated on cross-examination that very few company employees took advantage of the benefit on a regular basis. He also remarked that the Communications Act of 1934, which deals with the company's interstate business, made no mention of whether this privilege should be allowed or disallowed for rate-making purposes.

Mr. New testified on rebuttal that this policy of allowing a certain amount of free long-distance calls had been a

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long-standing practice of telephone companies. It was his opinion that it was an accepted principle of labor law that if you allowed employees a certain privilege over a long period of time, it becomes not just a privilege but a right. It was also his opinion that if the company attempted to withdraw this right from its employees, collective bargaining would be initiated by the CWA in an attempt to receive pay in lieu of the free long-distance calls. He felt that if this occurred the result would be additional expense over and above the revenue that the company is presently losing due to its policy.

This commission is of the opinion that these long-distance concessions are simply another fringe benefit received by the company's employees. We believe that if the company had to replace this benefit with another type of benefit or through additional wages, the cost would exceed the present amount. We consider this benefit as proper and will not accept the proposed adjustment.

Advertising Expense Adjustment

Staff witness Work proposed an adjustment to reduce commercial and marketing expense to eliminate for rate-making purposes the advertising related to improving the company's corporate image. This amount that he eliminated was characterized as corporate advertising expense. Department of Defense witness Dooley proposed an adjustment to eliminate for rate-making purposes corporate and promotional advertising. Included in Mr. Dooley's promotional advertising adjustment was advertisement related to competitive services and long-distance service. The company did not exclude any advertisement expense in the development of its case.

Mr. Dooley supported his adjustment for corporate and promotional advertising by stating that he did not believe that advertising of this nature should be allocated to the regulated portion of a regulated industry or to government sales, where governmental entities buy without advertising. Mr. Dooley stated that it was his opinion that corporate advertising to improve the public image of the company should not be allowed as an expense for regulatory purposes. He also felt that advertising related to competitive services and to long-distance service should be allocated to the competitive product and recovered through sales of those products instead of being recovered from the general ratepayer body.

On cross-examination, Mr. Dooley stated that he realized the revenues and investment related to long-distance service and the competitive items were included by he and the other two witnesses in the development of their respective cases. He also stated that if the company could identify that portion of advertising expense related to competitive service, he felt that portion would be an allowable item of expense.

Company witness Ballard stated on rebuttal that it would be patently wrong to disallow advertising expense associated with long-distance service and competitive service while at the same time considering the revenues, investment, and other expenses associated with these two areas as a part of the company's rate request.

This commission also feels that it would be inconsistent to disallow advertising expense associated with long-distance service and competitive services while at the same time using the revenues and investment associated with these two services as an input in our consideration of the additional revenue needed by the company. This commission's policy regarding telephone companies has been to allow advertising that is designed to increase revenues and/or decrease expenses. We feel that this is a sound policy and will, therefore, reject Mr. Dooley's recommendation concerning these two services.

Mr. Work was questioned as to the reasonableness of his adjustment to exclude corporate advertising for ratemaking purposes when the company is presently having to compete with other companies for the sale of terminal equipment. He was asked if it was not reasonable to conclude that competition forced South Central Bell to advertise to maintain its corporate image. Mr. Work responded that he had not excluded any advertising relating to the sale of competitive services, and that he felt the disallowance of corporate advertising would not adversely affect the company's position in the competitive market.

Mr. New stated on rebuttal that he did not think it had ever been established that corporate advertising was related to image building. He considered these expenses to be a proper and prudent business expense.

This commission feels that the amount of this type of advertising expended by the company was not unreasonable. We also feel that the record is unclear as to whether all of the advertising booked in the corporate advertising account is related to

improving the corporate image of the company. We, therefore, reject for this case the proposed adjustment to eliminate corporate advertising for ratemaking purposes.

Relief and Pensions Adjustment

Department of Defense witness Dooley proposed an adjustment to decrease relief and pensions expense due to the inability of the pension fund to earn its objective rate. Mr. Dooley theorized that for rate-making purposes the relief and pensions expense should be computed based on the objective earnings rate of the pension fund instead of the actual earnings rate.

This concept, advanced by Mr. Dooley, of assuming for rate-making purposes that a fund or account should earn an objective rate versus the actual rate earned is interesting to us. However, our review of the record indicates there was very little discussion concerning this question. We feel, because it is a theoretical argument new to us, that we need additional discussion on both sides of the issue to understand all of the implications of their concept. Therefore, we will not adopt the proposed adjustment at this time, but would urge the staff and the company to investigate this concept in future cases.

General Services and Licenses Adjustment

Department of Defense witness Dooley proposed an adjustment to decrease general service and licenses expense because he felt that the company had failed to show the reasonableness of certain of these charges as well as the benefit received by Tennessee customers. He proposed to eliminate either all or a portion of the charges for business research, computer-based studies, functional accounting, Washington office expense, New York state franchise tax, marketing salary expense, contributions, and social security expense among others. Mr. Dooley cited the possibility of a double-up in charges for the first three items and, in general, the need for further clarification of the benefits received from these charges as the basis for his adjustment.

Staff witness Work proposed an adjustment to decrease general services and licenses due to eliminating, for rate-making purposes, expenditures associated with the Washington office and associated with contributions and memberships. In Mr. Work's opinion, the Washington office expense fell into the category of lobbying expense. The reduction due to contributions and memberships was in accordance with his recommendation to eliminate all such expenses for rate-making purposes.

The record is replete with information and discussion concerning, not only these proposed adjustments, but also the license contract in general. After considering all of the evidence, this commission will not adopt the proposed adjustments by staff or DOD to general services and licenses expense.

Contributions and Membership Dues Adjustment

Staff witness Work proposed to eliminate for rate-making purposes all expenses associated with charitable contributions and membership dues of company employees. He contended that the customer should not be placed in the position of having his money contributed to an organization that he would not have contributed to himself. He stated that this expense had no relation to the type or quality of service received by the customer and, therefore, should not be allowed as an operating expense. His argument for disallowing membership dues was basically the same in that the expenditure was not service oriented.

Department of Defense witness Dooley proposed to disallow 87.5 per cent of the company's contributions to charitable organizations. He stated that he felt the company had some obligation to its community, with the shareholder having the major obligation and the customer having the minor obligation.

The company maintained on cross-examination and rebuttal that these were necessary and reasonable business expenses. They contended that all companies, unregulated as well as regulated, incur these expenses, and that they should not be

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penalized because they were regulated. The company stated that there was no evidence in the record that they had been imprudent in making these expenditures.

The commission feels that these expenses are reasonable operating expenses. We feel the company is expected to contribute to charitable organizations within its service area and to take part in civic organizations. We will not accept the recommended disallowance of these expenses.

Development of Twelve Months Ended March 31, 1977, Financial Data

We will use as a starting point the financial data filed by Mr. Ballard for the twelve months ended March 31, 1977. This information shows revenues of $430,437,000 and expenses of $358,054,000, leaving net operating income of $72,383,000 (Exhibit 6, Part 4). Consistent with our earlier findings, we will increase the recorded net operating income to reflect the federal income tax expense savings realized from filing a consolidated return, the disallowance of lobbying expense, and the imputation of revenues as though management employees paid 60 per cent of their local telephone service.

We have also deducted customer deposits in computing rate base. To allow the company to recover interest paid on customer deposits, it is necessary to include interest paid on customer deposits in the company's operating expenses. We will, therefore, reduce the company's operating income for the effects of including interest on customer deposits in operating expenses. Following is a summary of the adjustments to recorded net operating income for the twelve months ended March 31, 1977:

SOUTH CENTRAL BELL TELEPHONE COMPANY

TENNESSEE INTRASTATE

TWELVE MONTHS ENDED MARCH 31, 1977

'000' OMITTED

Line No.		
1	Net operating income (twelve months ended March 31, 1977)	$72,383
	Adjustments:	
2	Federal income tax savings	664
3	Lobbying expense, net	2
4	Local service concession to management employees	92

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5	Interest on customer deposits, net	(141)
6	Total (Lines 2+3+4-5)	$617
7	Net operating income as adjusted (Lines 1+6)	$73,000

Source: Lines 2, 3, 4: Exhibit 7. Line 5 = [(6 per cent x $4,519) x (1.00-.48)].

Known Change Adjustments

To make the recorded financial data as adjusted more representative of current economic conditions, we have decided to adjust the March 31, 1977, financial results for all known changes in revenues and expenses occurring through December 31, 1977, as though such changes had been in effect for the full twelve months. Set out below is a brief description and the amount of the adjustments.

SOUTH CENTRAL BELL TELEPHONE COMPANY

TENNESSEE INTRASTATE

TWELVE MONTHS ENDED MARCH 31, 1977

'000' OMITTED

Line No.		
1	Net operating income as adjusted	$73,000
	Changes occurring within the period:	
2	Interest during construction	379
3	Social security taxes	(81)

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4	Pension accrual rates	(134)
5	Management salary changes	(215)
6	Communications Workers of America contract changes	(1,245)
7	Dental plan	(96)
8	Amortization of investment tax credit	205
9	Interest expense	(98)
10	Independent company settlements	(266)
11	Changes resulting from Docket U-6073	347
12	Rate changes resulting from Docket U-6308	411
13	Rate changes resulting from Docket U-6382	2,996
14	Exchange regroupings	330
15	Basic medical insurance expense	29
16	Total [Lines 2+8+11+12+13+14+15-(3+4+5+6+7+9+10)]	$2,562

Changes occurring outside of period to December 31, 1977:

17	Rate change resulting from Docket U-6402, effective May 4, 1977	8,981
18	Rate changes resulting from Docket U-6439, effective June, 1977	125
19	Pension accrual and death benefit changes, effective July 1, 1977	30

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20	Communications Workers of America contract changes, effective August 7, 1977	(4,617)
21	Salary increase effective September 1, 1977	(869)
22	Change in management salary plan in 1977	(1,039)
23	Total (Lines 17+18+19-20-21-22)	$2,611
24	Total changes within period and outside period to December 31, 1977 (Lines 16+23)	$5,173
25	Net operating income as adjusted for known changes to December 31, 1977 (Lines 1+24)	$78,173

Sources: Lines 2 through 15, and 17 and 18: From Exhibit 6, Part 5. Lines 19 through 22: From Exhibit 3, 9(e), Sheet 2.

End-of-period Adjustment

An adjustment must be made to bring the net operating income realized for the twelve months ended March 31, 1977, adjusted for known changes, to a year-end level of customers. To make this computation we will follow the same approach used by company witness Ballard on Exhibit 6, Part 6. Following is the calculation:

SOUTH CENTRAL BELL TELEPHONE COMPANY

TENNESSEE INTRASTATE

TWELVE MONTHS ENDED MARCH 31, 1977

'000' OMITTED

Line No.		
1	Net operating income as adjusted for known changes	$78,173

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2	Net operating income on an end-of-period basis [Line 1 (excluding interest during construction) x 1.02049 (plus interest during construction)]	$79,701

We hereby adopt net operating income of $79,701,000 for the test year ended March 31, 1977, to test the company's earnings under the existing rate structure. Net operating income of $79,701,000 divided by the rate base of $913,413,000 found proper in this order indicates a rate of return of approximately 8.7 per cent under present rates.

Fair Rate of Return

As we stated on page 284 of this order, *supra*, the record in this case on fair rate return is the direct testimony, cross-examination, surrebuttal, rebuttal, and exhibits of company witnesses Faust and Meyer and the staff's witness Kosh that was entered in Docket No. U-6402. Because there was no new evidence presented in this case concerning fair rate of return, and because the evidence presented in this case is exactly the same as in Docket No. U-6402, we will repeat our analysis of this subject as found on pages 269 through 276 in the order in Docket No. U-6402, *supra*, 22 PUR4th 257.

A finding on fair of return is one of the most subjective determinations the commission must make in arriving at a decision concerning the proper level of rates for the company to charge its customers. We have the duty to make this determination based upon the controlling legal standards laid down in the landmark Bluefield and Hope cases. In the Bluefield case, the Supreme Court stated that 'a public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the county on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economical management to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.' (Bluefield Water Works & Improv. Co. v West Virginia Pub. Service Commission, 262 US 679, PUR1923D 11, 67 L Ed 1176, 43 S Ct 675.)

Later in the Hope case, the court refined these guidelines, holding that: 'From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise so as to maintain its credit and to attract capital.' (Federal Power Commission v Hope Nat. Gas Co. 320 US 591, 51 PUR NS 193, 88 L Ed 333, 64 S Ct 281.)

With these basic standards in mind, we will now discuss some of the important considerations that were presented in the record on the subject of fair rate of return. We believe that the standards, as set out in these two decisions, point up an important fact: The setting of a fair rate of return is not an exact science. A return that one informed person believes is fair and necessary to provide a comparable return enjoyed by other similar enterprises and to attract necessary capital may not be the same return as another informed person might believe.

Needless to say, our discussion is of necessity limited and cannot and will not be fully comprehensive of all relevant matters and components that go into the makeup of the determination of a fair rate of return.

The company presented witness Faust on direct and rebuttal, who recommended an 11 per cent rate of return, and witness Meyer on rebuttal on this issue. David A. Kosh, testifying on behalf of the staff, proposed a fair rate of return of 8.9 per cent. A comparison of their weighted cost of capital determinations and their rate of return recommendations follows:

Description	Capital Structure	Cost Rate	Weighted Cost	Fair Rate of Return Recommendation

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MR. FAUST				
Debt	45.0%	7.4 %- 7.6 %	3.33% - 3.42%	
Equity	55.0%	13.00%-15.00%	7.15%- 8.25%	
Total	100.0%		10.48%-11.67%	11.00%

MR. KOSH				
Debt	51.0%	6.89%	3.51%	
Preferred stock	4.0%	7.79%	.31%	
Common equity	45.0%	11.25%	5.06%	
Total	100.0%		8.88%	8.9%

Mr. Kosh also presented a bare bones rate of return of 8.55 per cent. It was his opinion that if the commission were to adopt a rate of return considerably below 8.55 per cent, we would get into the area of economic confiscation. Presented below is his computation of the bare bones rate of return.

Description	**Capital Structure**	**Cost Rate**	**Weighted Cost**
Debt	51.0%	6.89%	3.51%
Preferred stock	4.0%	7.79%	.31%
Common equity	45.0%	10.50%	4.73%
Total	100.0%		8.55%

Mr. Faust developed his recommendation on fair rate of return based on the consolidated Bell system's capital structure objective and South Central Bell's composite debt cost. Mr. Faust maintained that it is the consolidated Bell system's objective to have a debt-equity ratio of 45 per cent debt and 55 per cent equity, and, therefore, he used a hypothetical 45 per

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cent-55 per cent debt-equity ratio as the capital structure of South Central Bell for purposes of calculating a fair rate of return.

Mr. Faust developed his determination of debt cost based on the estimated level of debt at December 31, 1977, and his estimate of the interest rates which he expects the company will have to pay on debt issues issued in 1977. He first computed South Central Bell's embedded cost of long-term debt at September 30, 1976, to be 7.53 per cent. He stated that the company would sell an additional $250 million in bonds during 1977. He then estimated that the embedded cost of long-term debt after this sale would be between 7.62 per cent and 7.75 per cent. Mr. Faust stated that the amount of short-term debt varies, but over a period of time builds up to a substantial amount and is then financed permanently. He stated that short-term rates are quite volatile, but he believed that the impact of the present level of short-term money would be to moderate very slightly the company's embedded cost of total debt from the long-term embedded cost rate. Mr. Faust stated that the company's overall cost of all debt at September 30, 1976, was 7.44 per cent. Based on these assumptions and the embedded cost of long-term debt at September 30, 1976, Mr. Faust determined that the average interest cost of all debt capital which would be employed in 1977, would be in the range of 7.4 per cent to 7.6 per cent.

Mr. Faust used essentially two methods in arriving at his 13 per cent to 15 per cent recommended cost of equity capital. The first method was what he refers to as the maket approach, and the second method was the comparable earnings approach.

Mr. Faust advanced the theory that the cost of equity is equal to the debt plus a premium of 4 per cent to 5 per cent to recognize the higher risk of common equity capital. He based this theory on studies and articles by academicians and analysts that he had read. He then stated that based on an analysis of economic indicators and the general forecast of interest rates for the next few years, he estimated that long-term interest rates would be in the 8 per cent to 9 per cent range for the foreseeable future. So by adding the risk premium of equity capital over debt capital to the cost of debt, Mr. Faust developed a 12 per cent to 13 per cent range as his maket return. Mr. Faust tested the reasonableness of this 12 per cent to 13 per cent range through the use of the discounted-cash-flow (DCF) formula. Assuming that investors are expecting a 12 per cent to 13 per cent return on market value, he computed that investors were also expecting a growth rate of 5 per cent to 6.5 per cent. He tested his growth rate by analyzing the historical growth rates for AT&T and by analyzing market projections and found, in his opinion, that his growth rate was reasonable, and, therefore, his market return was reasonable. Using this market return of 12 per cent to 13 per cent, a payout ratio of 60 per cent, and a market-to-book ratio of 1.2, Mr. Faust computed, using the DCF formula, the required return on book equity to be in the range of 13.3 per cent to 14.4 per cent.

Mr. Faust tested the reasonableness of this return derived by the market approach by analyzing the earnings of groups of companies that he considered comparable to AT&T. He examined the historical earnings of market averages in general taken from Standard & Poor's 425 Industrials as well as the historical earnings of a selected group of quality stocks. He found that the average return on equity for the 425 Industrials was 13.7 per cent from 1971-75, and 14.5 per cent from 1966-75. He found that the average return on equity for the high-quality stocks had ranged between 17 per cent and 18 per cent for the two time periods. Since it was his opinion that investors compared AT&T with these high-quality stocks, he arranged these stocks into quintiles from the lowest earnings group to the highest earnings group. He then assumed that investors did not expect AT&T to earn as well as the highest group nor as poor as the lowest group. So he eliminated these two groups from his consideration. He then computed, for the remaining stocks, the average rate earned on average common equity for the period 1966-75 to be 14.7 per cent.

Based on his analysis and assumptions, Mr. Faust concluded that the return to common equity should be in the range of 13 per cent to 15 per cent.

Mr. Kosh used the hypothetical Bell system capital structure of 51 per cent debt, 4 per cent preferred stock, and 45 per cent common equity in his calculation of rate of return. He stated that the use of such a capital structure is both safe and economical. He made tests to determine that his capital structure would be able to withstand a depression more severe than that which hit the Bell system in the early 1930's. He also made other tests and determined that his capital structure was capable of withstanding an earnings decline with a one in 100 chance of occurring and still produce an aftertax interest coverage of 2.3 times. Besides being safe, Mr. Kosh asserted that the use of this hypothetical capital structure was economical as well. He stated that debt costs less than equity and, generally, as the debt ratio goes up, the cost of overall capital goes down. Once he had determined that his capital structure was safe, it automatically followed, in his opinion, that it was more economical.

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Another reason Mr. Kosh used a Bell system capital structure was that the Bell financing, including that of South Central Bell, is done on a system basis. He pointed out that the operating subsidiaries have different debt ratios, but that the important consideration is the consolidated Bell system debt ratio. Mr. Kosh testified that the financing of the various telephone subsidiaries is scheduled so that they do not interfere with each other. As a result, some units of the system must forego the chance of getting to the money markets at a favorable time, and thus pay a higher interest cost. He contended that it would, therefore, be unfair to assess this higher cost against the rates in a given jurisdiction. Mr. Kosh believes that the net benefits of system financing should be spread among all the operating subsidiaries by using the Bell system capital structure.

Mr. Kosh followed basically the same approach as Mr. Faust in calculating the cost rate for debt to be used in his determination of fair rate of return, except he used the debt cost of the Bell system consolidated. He derived the cost of long-term debt to be 6.90 per cent at December 31, 1976, for the Bell system exclusive of Western Electric. He then estimated the long-term debt to be refunded, to be repurchased, to mature, and the new long-term debt to be sold during 1977. Mr. Kosh estimated the short-term debt outstanding at December 31, 1977, with as associated cost rate of no more than 6.5 per cent. He then included the estimated debt of Western Electric at December 31, 1977, at a cost rate of 7.38 per cent. Based on his analysis and assumptions, Mr. Kosh forecasted the consolidated Bell system debt cost to be 6.89 per cent as of December 31, 1977, and used this in his determination of fair rate of return.

Mr. Kosh used the composite cost of the Bell system preferred stock of 7.79 per cent at December 31, 1976, in his calculation of fair rate of return. Mr. Faust did not discuss preferred stock in his development of a fair rate of return.

Mr. Kosh used the DCF formula to arrive at his recommendation of an 11.25 per cent cost of equity capital. He stated that this method recognizes that the interest of an investor in common stock is the future dividends and ultimate sales price of the stock. Since the value of a future dollar of income is less than the current dollar available for purchase of investment, the DCF formula is designed to recognize the discounted value of future dividends and growth in market price. This is accomplished by equating the current market price of a share of stock to the present value of all future cash receipts; i.e., dividends plus sales price discounted at a capitalization rate. The basic formula for this calculation is capitalization rate equals dividend yield plus growth (anticipated annual growth rate in dividends per share). According to Mr. Kosh, this formula will produce the base cost of equity.

Mr. Kosh determined that six Bell operating companies whose stocks are traded (Cincinnati Bell, Mountain States Telephone and Telegraph, New England Telephone and Telegraph, Pacific Northwest Bell, Pacific Telephone and Telegraph, and Southern New England Telephone) and AT&T were significantly similar to South Central Bell's operations based on statistical and financial data compiled on those companies, as well as uniformity of operations. Based on his analysis of the annual rate of the growth in dividends per share and book value per share of AT&T, and the six comparable Bell companies for selected periods from 1960 through 1975, he estimated the annual growth in dividends per share would be 3.75 per cent and 2.71 per cent, respectively. The average dividend yield component of the formula was based on the average dividend yields of AT&T and the six Bell companies for the three-year period 1974 through 1976, and was found to be 6.69 per cent and 8.21 per cent, respectively. Based on this analysis, Mr. Kosh determined that the capitalization rate for South Central Bell is 10.5 per cent.

Mr. Kosh then determined at what percentage above book value the market value of stock should be so that the sale of additional stock would not have a dilutive effect upon existing stockholders. He stated that market price above book value should be allowed so that costs associated with the sale of stock-- i.e., costs of financing and market pressures, which act to reduce the net proceeds to the company--would be covered in the market price so that existing stockholders would not experience a dilution of earnings. Mr. Kosh stated that there were three factors that should be considered in order to determine the appropriate rate to be earned on book equity: first, in what phase of the stock market are we now; second, what is the probable market drop for Bell stocks on a short-term basis; and third, what is an appropriate allowance for the cost of financing and pressure?

It is Mr. Kosh's opinion that the stock market has recovered to a point approaching an average market situation. Based on his analysis over the past two years of generally falling market prices, it is his opinion that it is reasonable to suppose that a 5 per cent margin of protection against short-term price declines in AT&T's common stock is appropriate. It is Mr. Kosh's opinion, based on studies that he has made over a period of many years, that the cost of financing and pressure is approximately 5 per cent. The question then is: How high above book would the market price have to be so that if the market price dropped 5 per

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cent due to a short run marked drop, plus a 5 per cent drop due to the cost of financing and pressure, it would still not fall below book value? The answer is that because of the compounding effect the market price would have to be approximately 1.11 times book value. From this analysis, Mr. Kosh concluded that the market price should be from 10 per cent to 15 per cent above book value.

Using the capitalization rate of 10.5 per cent, Mr. Kosh determined through the DCF method that an 11 per cent rate of earnings on book value would produce a market-to-book ratio of 1.10 and that an 11.25 per cent rate of earnings on book value would produce a market-to-book ratio of 1.15. He, therefore, determined that an 11.25 per cent return on common equity for South Central Bell would be proper.

Mr. Meyer, testifying in rebuttal of Mr. Kosh, expressed the opinion that the debt ratio for the Bell system should be no more than 45 per cent. He stated that this was necessary so that the Bell system bonds would not be downgraded. Mr. Meyer also testified that an 8.3 per cent cost of debt was appropriate to use in computing fair rate of return. It was his opinion that the spread between the cost of debt and the cost of equity was 3.1 per cent, and, therefore, that the base cost of equity was 11.4 per cent. Mr. Meyer also concluded that a market-to-book ratio of 1.2 was appropriate and that a return on common equity of 13 per cent to 15 per cent was reasonable.

As we have discussed previously, one of the causes of the significant difference in rate of return recommendations is the difference in capital structure proposed by the company witnesses and Mr. Kosh. Mr. Faust recommended the use of the consolidated Bell system objective capital structure containing 45 per cent debt and 55 per cent equity because it recognized South Central Bell's affiliation with the Bell system, and because he felt it would be an appropriate capital structure if South Central Bell were standing alone. Mr. Meyer also indicated that the Bell system objective capital structure should be used. Mr. Kosh has also recommended the use of an appropriate Bell system capital structure; however, Mr. Kosh's recommended capital structure contained 51 per cent debt, 4 per cent preferred stock, and 45 per cent common equity.

It is our opinion that Mr. Kosh was the only witness who demonstrated through supporting studies that his recommended capital structure was both safe and economical. We have discussed previously in this order the depression analysis that Mr. Kosh employed to support his contention that his recommended capital structure was both safe and economical. The proof presented by the company witnesses does not support a conclusion that their recommended capital structure is economical.

Mr. Faust contends that his capital structure and cost rates of debt and equity, which result in his 10.48 per cent to 11.67 per cent range for overall rate of return recommendation, must be used because they will provide interest coverage on a long-term basis that will be sufficient for South Central Bell to maintain its current debt rating. He also stated that if Mr. Kosh's position of increasing the company's debt cost was adopted throughout the country it would result in a lower rating of the company's debt. Mr. Meyer agreed with Mr. Faust in stating that the consolidated Bell system's stated objective of 45 per cent debt and 55 per cent equity was an important factor in sustaining the triple-A rating of the Bell system. However, we find no proof in the record supporting these assertions.

In arriving at his overall rate of return recommendation, Mr. Faust used the cost rates of debt for South Central Bell which he estimated to be between 7.4 per cent and 7.6 per cent. Mr. Kosh used the cost of debt of the Bell system at December 31, 1977, which he estimated to be 6.89 per cent.

Mr. Faust stated that the sole purpose of the company's case was to present evidence concerning the costs of providing intrastate telephone service. He went on to state that since capital costs are just as real as wages, depreciation, taxes, etc., then it was appropriate to use the debt cost of South Central Bell rather than the Bell system.

The inconsistency of using South Central Bell's cost rate of debt with the Bell system's objective capital structure as Mr. Faust proposes is obvious. Since South Central Bell is 100 per cent owned by AT&T, it is clear that the financing of the various subsidiaries is done on a system basis. Mr. Kosh stated that the cost of debt for any particular unit of the system may differ from that of the total system primarily due to the different timing and amount of debt issues floated by that particular unit. Hence, certain units will have a higher or lower embedded cost than the system as a whole. However, any such difference is not due to any difference in the quality of the bonds, but rather to the relative timing of the issues. We agree with this reasoning and, therefore, can find no rationale for using, as Mr. Faust does, the cost rate of debt for South Central Bell along with the capital structure of the Bell system.

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We will now turn our attention to a discussion of the cost of equity recommendation. As has been previously discussed, Mr. Faust recommended a cost of equity in the range of 13 per cent to 15 per cent. In summary, Mr. Faust's recommendation was derived in the following manner. Based on studies performed by others, Mr. Faust concluded that the risk premium of equity capital over long-term debt is in the 4 per cent to 5 per cent range. He then added 4 per cent and alternately 5 per cent to his estimate of the cost of long-term debt, 8 per cent, and thereby obtained a market expectation of 12 per cent to 13 per cent, which he characterized as being the cost of equity.

Mr. Faust stated that he obtained the 4 per cent to 5 per cent range from studies and articles by academicians and analysts. He furnished, in response to a staff request, a sample of the articles upon which he relied. This sample consisted of two magazines, one newspaper and one brokerage house article, and two studies done by Messrs. Ibbotson and Sinquefield (I-S study). One of the I-S studies related to the period 1926-74, whereas the other related to the period 1976-2000.

The record indicates that in none of the magazines, newspapers, and brokerage house articles was any equity risk premium independently determined. These articles simply commented on or reported the results of studies done by others. The studies performed by others referenced in these articles consist of the I-S study, a Fischer-Lorie study, and a Nordhaus (Brookings) study.

The Fischer-Lorie study did not develop an equity risk premium or a spread between the cost of debt and the cost of equity and in fact concluded that the data for bond costs were not available. The Nordhaus study did develop an equity risk premium, but Mr. Faust did not know how this premium was developed. Mr. Nordhaus did establish that the equity risk premium averaged 1.5 per cent over the period 1968-73, and he found that the rate premium was four-tenths of one per cent in 1973. Mr. Nordhaus also concluded that the risk premium and cost of capital experienced over the past few years appeared to be in equilibrium. However, what Mr. Nordhaus did not conclude was that the equity risk premium was in the range of 4 per cent to 5 per cent, the range used by Mr. Faust.

This leaves the I-S study as the support for the 4 per cent to 5 per cent spread. The I-S study does develop a spread in the range of 4 per cent to 5 per cent. The spread was 4.9 per cent over the period 1926-74. However, over the most recent 15-year period available, the spread has been far below the 4 per cent to 5 per cent range. Only five out of the fifteen years was the spread positive, the highest being 1.7 per cent. Mr. Faust's response to this was that one cannot look to the last fifteen years to assist one in developing the cost of equity; instead, one must look at the last fifty years. In summary, we are not persuaded by Mr. Faust's opinion that the 4 per cent to 5 per cent spread is reasonable, is normal, or is expected. There is no evidence in the record showing that the 4 per cent to 5 per cent range is anything other than a 50-year average.

Mr. Meyer testified, in rebuttal to Mr. Kosh, that his study showed that the spread, or risk premium, for AT&T was 3.1 per cent. It will be recalled that Mr. Faust indicated that a 50-year period should be used and that the period 1960-76 was tainted. Mr. Meyer's spread studies in which he developed his 3.1 per cent are based on the last sixteen years. The record does not disclose what Mr. Meyer's spread is supposed to represent. Is it the difference between the cost of debt and the cost of equity? Mr. Meyer did not say. The determination of the cost of equity cannot be left to conjecture.

Mr. Faust compared his 13.3 per cent to 14.4 per cent to what various groups of unregulated industries had earned over the period 1966-75. It was recognized by Mr. Faust that the higher the risk the higher the return required. He also indicated that a higher quality rating meant a lower risk at least as concerns historical performance. However, the facts are not consistent with this theory. The record indicates that the stocks with the highest earnings were those of the lowest risk. This apparent inconsistency was not adequately explained by Mr. Faust and leaves some doubt in our minds as to the usefulness of these data in determining the cost of equity.

As concerns relative risk, Mr. Faust discussed it but made no attempt to analyze it. Mr. Faust indicated that one cannot analyze risk without reference to market prices, and that the market price embodies the investor's appraisal of risk. Mr. Faust made no study of risk in terms of the market price.

We feel that Mr. Kosh's approach in determining the cost of equity is a valid and reasonable approach. We may not agree precisely with each detail of the method that he used to arrive at his recommended cost of capital; however, we feel compelled to say that we attach more weight to his recommendation than that of the other rate of return witnesses.

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We have carefully considered the criteria set forth in the Bluefield and Hope cases and have applied our informed judgment to all the evidence in this record on the subject of fair rate of return. We have weighed all the factors considered by the witnesses testifying in this proceeding and have discussed heretofore in this order certain portions of the record we feel are appropriate to this subject.

In the majority decision rendered in May of this year, 9.1 per cent was found to be fair. The minority opinion took the position that the lower end of the zone of reasonableness was 8.55 per cent and should be used to calculate the necessary rate increase. Given the fact that our last rate award has only been in effect for about half of a year, and the company filed for another rate increase only two months after we issued our order, we find that the historical test-year rate of return of 8.7 per cent falls within the zone of reasonableness. We have said many times before that a fair rate of return is not keyed to a knife-edge point, and that a company might earn a little less or a little more and still remain in the zone of reasonableness. We believe that the rates that South Central is presently charging its customers produce sufficient revenues to cover expenses and provide a rate of return that is safely within the zone of reasonableness. Therefore, we believe the $92 million rate request is unjust and unreasonable and should be denied in its entirety.

We note that our findings on capital structure and equity are consistent with the Internal Revenue Service regulations which provide certain limitations as to how JDIC is to be treated in computing the capital and rate base of a utility. We also note that staff witness Burcham has pointed out in his testimony that because of these limitations imposed by the Internal Revenue Service regulations, the actual return on equity will be approximately one percentage point higher than the equity return that we used to compute the rate of return of 9.10 per cent which was adopted in Docket U-6402.

This order contemplates the same service level as that proposed by the company in its filing.

Rate Design

The company filed revised tariff schedules designed to produce $91,044,000 in additional gross revenue. Of the $91,044,000 annual revenue increase, $82,112,000 would be derived from increases in basic local exchange service and related items; $2,906,000 from increases in service charges; $1,236,000 from increases in toll service; $5,907,000 from increases in miscellaneous services; $311,000 from increases in private lines; and $872,000 from increases in competitive services.

The company also filed an alternate proposal to the above mentioned schedule. This alternate would increase the coin-telephone rate from ten cents to 25 cents and allow South Central Bell to charge for directory assistance service. With the incorporation of directory assistance repricing and the coin-telephone rate of 25 cents, South Central Bell was requesting additional annual revenues of $91,101,000. The effects of this alternate proposal would reduce the annual increase in basic local exchange service and related items from $82,112,000 to $65,152,000. It would combine a revenue increase and cost reduction amounting to $12,853,000 as a result of directory assistance repricing. Finally, this alternate proposal would produce $4,154,000 in annual revenue by increasing existing coin-telephone rates.

Following is a schedule showing the company’s proposed annual increase in gorss revenue based on the company’s rates by type of service.

SOUTH CENTRAL BELL TELEPHONE COMPANY

SUMMARY OF TENNESSEE INTRASTATE PROPOSED RATE CHANGES

	1978 Annual Basic Proposal Revenue Increase	
	Basic Proposal	**Altermate Proposal With DAR & 25 Cents Coin**

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Basic Local Exchange Service:

Basic Service--One-, Two-, and Four-party Business and Residence Flat Rate, PBX Trunks, and Semipublic Coin Monthly Rates ...	$73,099,000	$56,774,000

Related Services:

Grouping Service	5,530,000	5,205,000
Joint User Service	28,000	25,000
Centrex Stations.....	3,290,000	2,993,000
Announcement Line Service	25,000	21,000
Mobile Telephone Service	140,000	134,000
Subtotal.....	$82,112,000	$65,152,000
Service Charges	2,906,000	2,906,000
Long-distance Service-Message Toll Service	1,236,000	1,236,000

Miscellaneous Services:

Directory Listings	1,048,000	1,048,000
Coin-telephone Equipment	7,000	7,000
Telephone Answering Service Facilities.....	80,000	80,000
FMAS & FX	469,000	469,000

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Key and Pushbutton Telephone Service	263,000	263,000
PBX Service	162,000	162,000
Centrex Equipment and Associated Items	90,000	90,000
Miscellaneous Service Items	2,176,000	2,176,000
Auxiliary Equipment	1,255,000	1,255,000
Mobile Equipment	43,000	43,000
Obsolete Service Items	314,000	314,000
Private Line:		
Equipment	17,000	17,000
Interexchange Service	294,000	294,000
Competitive Service Tariffs	872,000	872,000
Directory Assistance Repricing	Not Applicable	12,853,000
25-cent Coin-telephone Rate--Local Calls	Not Applicable	4,165,000
Less Increase in Independent Company Steelements	-2,300,000	-2,301,000
Total	$91,044,000	$91,101,000

The company proposed to increase individual line rates for residential service by $3.75 per month and business service by $6.65 per month. The existing rate relationship for residential party-line service and for all grades of business service was generally maintained in the proposed schedule. No increase in eight-party service was proposed. Centrex exchange access

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increases were proportionate to the increases in basic exchange service rates. The existing rate relationships were maintained for PBX trunks, semipublic monthly rates, auxiliary line charges, joint user service, and business message rate service monthly charges. The grouping service or rotary line charge would increase from 1.2 to 1.3 times the business individual line rate.

Under the proposed tariff, service connection charges would increase by $2,906,000. Company witness Fray explained that this increase was necessary so that those customers causing such costs would more nearly cover them in the rates they pay. South Central Bell's proposal would not raise current rates over 50 per cent in any case.

Message toll service would be increased by $1,236,000. This proposed change increased the evening rate from 62 per cent to 65 per cent of the day rate.

The company requested an annual increase of $5,907,000 for miscellaneous items of equipment and service included in their tariffs. This approximate 20 per cent increase would apply to hundreds of tariff items with the following exceptions: (1) items for which current rates had been set during the last three years; (2) items for which there was a cost study indicating that rates currently cover costs; and (3) rates for data sets and tariff items primarily intended for use with the handicapped.

Private-line services were proposed to increase by $311,000 annually. Of this $311,000, $17,000 would affect equipment associated with private-line services and $294,000 would affect interexchange service.

The company, in a late filing to this case, proposed that competitive service tariffs be increased by $872,000 annually. The company performed a long-run incremental analysis to select the proposed rates for 701 PBX service and ComKey 718 service. Changes in rates for 756 PBX service, 2B Automatic Call Distributor service, and ComKey 734 and ComKey 1434 service were proposed in response to the company's study of the demand for these services.

The company requested a directory assistance repricing plan under their alternate proposal. This repricing plan would establish a charge of 20 cents per call for all calls to directory assistance after an allowance of three calls per month. This 20 cents charge would be eliminated of intrastate long-distance directory assistance calls if the number of such calls did not exceed the number of intrastate long-distance calls billed within the same billing period. The charge would not apply to calls made to directory assistance from coin telephones, motel/hotel rooms, hospital patient rooms, and from telephones of the visually or physically handicapped subscribers. The company maintained that this 20 cents charge along with the destimulation in directory assistance calls would allow them to reduce the monthly local exchange rates by 80 cents.

Also included under this option was a provision which would allow the coin telephone rate to increase from ten cents to 25 cents. This proposed increase would allow the company to reduce basic local exchange rates by 25 cents per month. The annual revenue increase from this proposal would amount to $4,165,000.

The effect of directory assistance repricing and the increase in coin telephone rates would allow the company to reduce their proposed basic local exchange rate by $1.05 per month for each line.

During the proceedings of this case, intervenors representing answering service companies throughout Tennessee were heard. They requested that the commission direct South Central Bell to act in accordance with their proposals. These proposals maintain that South Central Bell should:

1. Restructure their service connection charges to include a specific charge for the installation of secretarial lines not to exceed $10.25 for business customers and an amount proportionately less for residential customers;

2. Create a mass move charge for secretarial lines similar to the charge adopted in the state of Illinois;

3. Implement a credit against the charge for a concentrator identifier equal to $2 times the number of customers served by the concentrator identifier;

4. Deny the company's request for a 20 per cent rate increase on telephone answering service switchboards and related equipment;

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5. Exempt answering service companies from the application of any directory assistance repricing plans;

6. And finally, freeze all rates affecting answering service companies until a separate proceeding can be instituted to determine the amount and means of compensating answering service companies for revenues generated by them which South Central Bell would not otherwise receive.

Because of our decision to deny the requested rate increase in its entirety, we feel that the present tariffs should not be changed. We also specifically deny the directory assistance repricing plan as well as the proposed increase in the local coin-telephone rate. From the evidence in this record, this commission is of the opinion that the majority of the customers do not want the DAR plan adopted. We realize that the general customer body is paying through local service rates for directory assistance. We are convinced, however, that the customer body at the present time is satisfied with the current pricing scheme. It is also our opinion, from evidence in this record, that the majority of the customers do not want the local cointelephone rate increased. We are aware that this service is being subsidized by other services, but we feel that customers are presently satisfied with this arrangement. We are also concerned by the fact that the company is estimating a 40 per cent destimulation of local cointelephone calls if this increase were granted. To illustrate our concern with a very simple example: Assume that ten calls are made under the present tariff. This will produce $1 in revenue (ten calls x ten cents). The company is proposing to increase the rate from ten cents to 25 cents. One could assume that the company would then receive $2.50 under the proposed rates (ten calls x 25 cents). But the company says that this assumption is not correct. They state that if the local coin-telephone rate is increased to 25 cents, they will lose four calls and will only receive $1.50 in revenues under the proposed rates (six calls x 25 cents). This amounts to an increase of 50 per cent in revenues from a 150 per cent increase in rates. In our opinion, the increase in revenues does not justify the increase in rates.

CLEMENT, chairman, dissenting in part:

I must respectfully dissent from the conclusions expressed in the order relating to the rejection of the staff's proposed adjustments to eliminate corporate advertising expense and Washington office expense for rate-making purposes. My analysis of the record indicates that the staff was correct in recommending the commission's adoption of these two adjustments. The record contains examples of the type of advertising included in corporate advertising expense. These examples indicate that this advertising is designed for no other purpose than to promote the corporate image of South Central Bell. It is my opinion that this commission order should only allow advertising expense for telephone companies that is designed to increase revenues and/or decrease expenses. It is my conclusion that corporate advertising expense does neither.

The record indicates that Washington office expense is composed of lobbying expense as well as other expenses incurred by AT&T in its interaction with federal agencies and bureaus. That portion of the Washington office expense that can be classified as lobbying expense should be disallowed for rate-making purposes. This commission has properly excluded lobbying expense on the state level in this order, as well as in past orders, and should have excluded the lobbying expense on the federal level in this order. Although the dollar amount may be immaterial, the principle involved is highly important.

ATKINS, commissioner, dissenting in part:

I must respectfully dissent from the conclusions expressed in the order relating to adoption of an historical test year, finding on fair rate of return, and rejection of the directory assistance repricing plan. My analysis of the voluminous record made in this case leads me to the conclusion that South Central Bell should have been authorized to increase its rates sufficiently to produce additional annual revenue of $32,992,000. The details of this calculation are shown in Appendix A [omitted herein] to this statement.

The basis of my conclusion rests on my firm conviction that my two colleagues made two major errors in arriving at the commission's final decision. First, they relied solely on historical information to test the company's cost levels disregarding known changes that make such information already out of date even from the date of the decision, totally disregarding any reasonable future period during which the current rates are to remain in effect; and, second, they reduced the allowed rate of return to 8.7 per cent from 9.1 per cent found in our last order to be appropriate. I find no evidence and no justification for a reduction in the allowable rate of return found in our last order which placed the current rates in effect in mid-1977.

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My colleagues found that an historical test year should be used as opposed to the finding of the staff and company's recommendation that a forecasted test year be used. The major reason given for this position was that the forecasted numbers could not be verified, and that they were too speculative. Further, my colleagues found that the concept of a forecast leans heavily in the direction of guaranteeing the company a rate of return, which would have the effect of taking away management's incentive to control costs and operate efficiently and, therefore, minimizes the commission's ability to act as a substitute for competition.

All of these reasons may sound good in theory, but let us examine the facts. The historical test-yesr rate of return suggests the company will earn an 8.7 per cent rate of return. The company's forecast for 1978 suggests it will only earn a 7.6 per cent return, while the *staff's forecast* indicates the company will earn 7.5 per cent. If these forecasts are reasonably accurate, and the evidence supporting the validity of the forecasted amounts is voluminous and has been carefully audited by the staff, then it is obvious the company will fall short of achieving even the 8.7 per cent by more than a full percentage point. If this happens, as appears extremely likely, then we have failed to afford the company an opportunity to earn a fair rate of return as required by law.

Performing our regulatory function in a period of rapidly increasing costs is not easy; nor is it made easier by jumping from a forecasted test period to a historical test period as has been done by the majority, without, I submit, any justification for such change of approach. If we are to fulfill our responsibility to the public of seeing to it that they have a high quality of telephone service, we must recognize that historical cost levels are not representative of the future and must adopt a 'test period' which will provide the utility with a reasonable opportunity to earn the rate of return found to be fair. Based on the facts I have examined in this particular case, it can only be done by giving consideration to changes that the record shows will occur in the near future. The staff recommended that such consideration be accomplished by using a forecasted test year and I agree. The majority's decision to revert back to an historical test year is a step backward in setting rates in the current economic climate, and is not supported by any evidence in the record. Furthermore, it is obvious that the company will not have a reasonable opportunity to earn even the 8.7 per cent found by the majority; and in the absence of some allowance for the attrition caused by inflation, which the majority does not recommend, will make it impossible for this company to earn whatever rate of return the commission finds to be appropriate. This is demonstrated by clear and convincing proof in the record, both by the company's witness and by the commission's staff, which the majority has ignored.

The record shows that this company has not been able to achieve the authorized rate of return through rates fixed by this commission during any of the six previous years. There are, of course, isolated months in which expenses may not catch up with revenues and therefore a distorted rate of return for a single month or two may result. The result, of course, is that the fair rate of return fixed by the commission is but an illusion, impossible for the utility to achieve. When this inequity was demonstrated to us on the previous record (Docket No. U-6402), we agreed on recommendation of our staff accountants, to remedy the situation by fixing the company's rates on forecast data. There is nothing in this record to indicate that our decision was improper and should be reversed. In fact, the proof is to the contrary. The commission staff has again recommended the use of forecast data, utilizing the calendar year 1978 as its test year.

The record also shows that the staff accountants spent two weeks on company premises auditing its records and gathering data to support its forecast. In addition, the company filed a substantial amount of financial data with its petition to aid the staff in its audit of the company's forecast and the staff requested and analyzed additional financial data from the company. In fact, the commission staff's forecast of company net operating income was again extremely close to the forecast offered by the company for 1978. The same was true for the commission staff and company forecasts offered for the year 1977 as noted in our previous order.

The only other recommended test period data in the record were those offered by an intervenor, Department of Defense, representing the federal agency customers. While the DOD witness' approach to fixing rates for 1978 was to use only historical data, he did use a more recent period ending July 31, 1977, than that used by the commission majority. The DOD witness also recognized the attrition problem by adjusting the historical data for known changes that will occur in 1978. While the approach recommended by DOD will more nearly enable the company to achieve the allowed rate of return than that adopted by the majority of the commission, it does not, in may opinion, take into account all the known changes, both up and down, that will affect the company's earnings in the reasonable future.[1] Only a forecast period can do that, and even its validity will normally be limited to the period of time covered by the forecast if the utility continues to be faced with inflation

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at the 5 per cent to 6 per cent level when it must take large additions to its investment to meet growth demands.

In view of the foregoing facts, and the *complete lack of evidence* in the record to support a reversion to the use of historical data ending March 31, 1977, and rejection of all the changes that the record shows will occur during the year 1978, I conclude that this company's rates for 1978 should be determined from the forecast of the company's operations for the year 1978 submitted by the commission staff with the adjustments agreed upon by the commission. This would result in a gross revenue deficiency of $32,992,000. In my opinion, this procedure is the most practical way to accomplish the stated objective of the majority of limiting the frequency with which utilities regulated by this commission must request rate increases. Certainly, setting rates based entirely, or even substantially, on historical data, as the majority does, works in the opposite direction and produces rates that, because of the forces of inflation and growth, are outmoded and incapable of yielding the stated rate of return during the immediate future when they are to be in effect. But what is even more important, it will likely result in poor service to the customer body.

Fair Rate of Return

I also disagree with the majority's conclusion that a rate of return of 8.7 per cent falls within the zone of reasonableness. In the last order issued in May of this year, a majority of the commission, including myself, found a fair rate of return to be 9.1 per cent. The staff and the company stipulated that the rate of return evidence presented in the previous record would constitute the rate of return evidence in the present case. Under these circumstances it appears to me that it is inconsistent for me to reach a different conclusion on the identical proof in absence of proof of changed economic circumstances.

The company's rate of return witness testified that a fair rate of return was 11 per cent. Mr. Kosh, testifying on behalf of the commission staff, stated that a fair rate of return was 8.9 per cent. The 8.7 per cent rate of return found by the majority decision in this case is below even the 8.9 per cent recommended by Mr. Kosh and considerably below the 9.1 per cent found to be fair eight months earlier on the same testimony. Since the evidence on fair rate of return is the same as in the last case, it is my opinion that the majority should have reaffirmed the commission's previous finding of 9.1 per cent. An 8.7 per cent rate of return, even if it could be achieved, and I do not think it can under the majority order, is insufficient to allow the company the ability to attract capital and provide good telephone service. I believe that a 9.1 per cent rate of return is required to allow the company to attract the necessary capital to meet its customer demands for good quality telephone service.

I have again gone into this matter as thoroughly as I am capable and as I did in the previous two dockets, and I find nothing in this record that would indicate any change in the cost of capital as it applies to this company's operation in this state that would justify lowering the fair rate of return allowance below 9.1 per cent as previously determined by this commission. Nor does the majority offer any rationale for such change. The testimony in this record on fair rate of return is exactly the same as it was when we found 9.1 per cent on May 4, 1977.[2] To reach a different conclusion, specifying a lower cost of capital, when the record shows the company's additional capital requirements for Tennessee were $296 million in 1977 and will be another $298 million in 1978, cannot be justified and is not explained in the majority decision.

Reducing the rate of return without any sound basis in economic fact leaves the company in a difficult position, since this commission has adopted service standards which must be followed. It is not reasonable to expect a utility to meet standards designed to provide a high quality of service unless the utility is given adequate revenues to attract the necessary capital to provide that service. That is why a fair rate of return is one of the most vital determinations that we must make in establishing just and reasonable rates. If the return is too high it will result in unreasonable rates being assessed against the customers, but, on the other hand, a return that is too low will result in penalizing the investor and adversely affecting the ability of the utility to attract capital on reasonable terms. It is this latter result that we will be inviting by lowering the fair rate of return without clear and convincing evidence in the record directing that we should do so. There is no such evidence in this record. I, therefore, conclude on the evidence before me that the fair rate of return for South Central Bell is 9.1 per cent as found by this commission on May 4, 1977, on the same evidence in that proceeding.

Directory Assistance Repricing Plan

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The company, in its petition, proposed to reprice directory assistance service so the those customers who use it will pay more of the costs.

The record in this case reveals that the entire body of telephone users in Tennessee will pay approximately $17 million with telephone bills in 1978 under the present plan and the plan adopted by the commission majority.

The directory assistance repricing plan would, if adopted, provide customers with three calls per month to a directory assistance operator before charging begins. If a customer made more than three calls within his local calling area, he would be charged 20 cents for each call over the 'three-call allowance.' Furthermore, there would be no charge for an in-state DA call unless the number of such calls exceed the number of in-state long-distance calls made from a customer's phone during any given billing period.

The 20-cent DA charge would reduce 95 per cent of the customer telephone bills. The evidence indicates that the company would be able to reduce its annual cost by $10,461,000. I believe that the benefit of this potential cost savings should be passed on to the 95 per cent of the customers who do not make extensive use of this service. For those who make extensive use of the service, I think it is only fair that they pay the cost of providing this service. It is my opinion that the commission should have adopted the proposed directory assistance repricing plan.

Most residential customers would receive a reduction in their local service bills of 80 cents per month, or $9.60 over a year's time. To me, this is a consideration that we cannot ignore or disallow on the basis that it will reduce the number of people that are working for the telephone company. The time has come when we *must* take into consideration not how many people work for the telephone company but how efficiently they work, and that they are paid competitive wages and salaries with other people rendering similar services. That to me is basic. I would, therefore, insist that the *users of the service pay for it* so that the nonusers could received a considerable reduction in the cost of their telephone service.

As I have previously stated in the discussion of this case, it is my opinion that South Central Bell should be granted $32,992,000 increase in annual gross revenue, which with approval of their directory assistance repricing plan, could be reduced by about one-third.

Of this amount, $11,232,000 could be obtained through the approval of the increases sought in service connection charges, long-distance directory listings, private line, competitive equipment, and other miscellaneous services rates. This would leave $9,656,000 to be obtained from local basic service rates and related rates. This increase would require only a *15 cents per month increase* for the individual line residence customer and *$1.40 per month for the individual line business customer*, with party-line service increases being even less.

I believe these increases are both necessary and reasonable in order to maintain good telephone service for the future.

Footnotes

1 Department of Defense's recommended revenue deficiency using a 9 per cent rate of return for convenience is $22,510,000. The witness testified that for each one-tenth of one per cent variance in rates, revenue requirements of $2,210,663 would be used to adjust.

2 In fact we may be on the conservative side considering that the Federal Communications Commission allowed a return on capital of 9- 1/2 -10 per cent, 12 per cent on equity, in its order of February, 1976, Docket No. 20376.

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Consumer Advocate

Attachment 1-17

Table of Contents

Document Title	Reference
19-00072 Order Approving Agreement	Footnote 5

BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION

NASHVILLE, TENNESSEE

January 22, 2020

IN RE:	)	
	)	
PETITION OF ATMOS ENERGY CORPORATION FOR APPROVAL OF AGREEMENT WITH BROWN-FORMAN CORPORATION, d/b/a JACK DANIEL DISTILLERY	))))	**DOCKET NO. 19-00072**

ORDER APPROVING AGREEMENT

This matter came before Commissioner Herbert H. Hilliard, Commissioner John Hie, and Commissioner David F. Jones of the Tennessee Public Utility Commission (the "Commission" or "TPUC"), the voting panel assigned to this docket, during a regularly scheduled Commission Conference held on December 9, 2019 for consideration of the *Petition of Atmos Energy Corporation for Approval of Agreement with Brown-Forman Corporation, d/b/a Jack Daniel Distillery* ("*Petition*") filed on August 14, 2019.

BACKGROUND AND *PETITION*

In its *Petition*, Atmos Energy Corporation ("Atmos" or the "Company") requests approval of an Agreement for Extension of Distribution Main and Interruptible Service ("Agreement") with Brown-Forman Corporation, d/b/a Jack Daniel Distillery ("Jack Daniel"). In order to obtain necessary capacity for its increasing natural gas requirements, Jack Daniel desires that Atmos would extend its natural gas system and has negotiated the Agreement with Atmos for such extension. The Agreement calls for Atmos, upon Commission approval, to install approximately 21,000 feet of eight-inch steel natural gas pipeline in Moore County, Tennessee.

The new pipeline will connect the Jack Daniel Distillery in Lynchburg, Tennessee, with the interstate pipeline operated by Enbridge Incorporated (d/b/a East Tennessee Natural Gas).[1]

In general, the terms of the Agreement are as follows:

1. Atmos will construct the facilities;

2. Jack Daniel will make Aid-In-Construction (AIC) payments to Atmos;

3. Atmos will provide gas service to Jack Daniel in accordance with then-current rates under Atmos's Tariff 250 (Interruptible Gas Service) or if elected by Jack Daniel, under Tariff 260 (Transportation Service);

4. Jack Daniel will exclusively use Atmos for delivery of its natural gas requirements; and,

5. Jack Daniel will make a minimum level of gas purchases during the initial 15-year term of the Agreement, which includes provisions concerning corresponding margin shortfall contributions.[2]

Atmos's *Petition* states that while the pricing of the gas to be provided is in accordance with then-current tariffed rates, the provisions regarding minimum margin requirement are not specifically authorized by the Company's existing Tennessee tariffs. As a result, Atmos filed its *Petition* to obtain TPUC approval of the Agreement. In support of its *Petition*, Atmos states that approval of the Agreement will benefit Tennessee ratepayers and serve the public interest.[3] In addition, Atmos submitted the Pre-Filed Testimony of Daniel P. Bertotti.[4]

Mr. Bertotti testifies that Jack Daniel plans to increase its use of natural gas due to a conversion from burning wood and/or sawdust to burning natural gas exclusively in its ongoing

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[1] *Petition*, p. 2 (August 14, 2019).
[2] *Id.* at 2-3.
[3] *Id.* at 3.
[4] Daniel P. Bertotti, Pre-Filed Direct Testimony, p. 2 (August 14, 2019).

operations. In order to accomplish the conversion, Jack Daniel requires additional capacity that Atmos cannot provide via current facilities. Therefore, Atmos will install approximately four (4) miles of high pressure steel main to increase capacity to serve Jack Daniel. Mr. Bertotti testifies that the installation will enhance ongoing operations and allow Jack Daniel to increase production in the future.[5]

Mr. Bertotti also states that the Agreement will provide the following benefits to Atmos ratepayers: an environmental benefit from conversion to a cleaner energy source; an environmental benefit from the elimination of woodburning by Jack Daniel; a local economic benefit from increased future production at Jack Daniel; and, a cost sharing benefit to ratepayers from the increased usage, and hence, increased cost of service contribution, by Jack Daniel.[6] He also testifies that no special discounted rate is provided to Jack Daniel in the Agreement. However, the terms of the agreement do require Jack Daniel to compensate Atmos for any difference between the revenue generated by its future use and the minimum margin requirement necessary to justify the new pipeline extension installation. Mr. Bertotti states that this minimum margin requirement could potentially lead to the Company paying a price per Ccf that is higher than that listed in the approved tariff and thus requires Commission approval.[7]

Further, Mr. Bertotti provides testimony concerning the capital investment for the extension project. A portion of the funding will come from AIC payments to Atmos from Jack Daniel, occurring in three up-front installments. The remaining portion of the funding will be provided by Atmos, but will be covered by Jack Daniel's estimated usage as set forth in the Agreement.[8] Finally, Mr. Bertotti states that the terms of the Agreement comply with Section 7.1

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[5] *Id.*
[6] *Id.*
[7] *Id.* at 3, 5.
[8] *Id.* at 4.

of Atmos's General Rules and Regulations concerning extension policy, as Jack Daniel is required to submit AIC to the Company only to make up the difference between actual and allowable rate of return based on a feasibility study performed by the Company.[9]

The Hearing Officer assigned to this docket issued a *Protective Order* concerning certain confidential information on September 24, 2019. Following requests for data by Commission Staff and respective responses by the Company, the Hearing Officer issued a Notice of Hearing. No other party requested intervention in this docket.

STANDARD FOR AUTHORITY APPROVAL

TPUC Rule 1220-04-01-.07, states:

> Special contracts between public utilities and certain customers prescribing and providing rates, services and practices not covered by or permitted in the general tariffs, schedules or rules filed by such utilities are subject to supervision, regulation and control by the Commission. A copy of such special agreements shall be filed, subject to review and approval.

In general, a special contract providing for discounted transportation rates in order to avoid a potential customer bypass of the utility's system is subject to additional scrutiny, in which the Commission must find:

1. Customer bypass is imminent;
2. Customer bypass would be uneconomic;
3. Special contract rates and terms are just and reasonable and such terms are not unjustly preferential or unduly discriminatory; and,
4. The special contract rates are the highest that could be negotiated.

However, these general criteria are not directly applicable to this matter, as Jack Daniel is a current customer of the Company, there is no intent to bypass Atmos's system, and the Agreement requires Jack Daniel to exclusively use Atmos for delivery of its natural gas requirements. Therefore, the Commission reviews the special contract to determine whether the

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

contract rates and terms are reasonable, whether departure from the utility's tariff is justified, and whether the special contract arrangement is in the public interest.

THE HEARING

The Hearing in this matter was held before the voting panel of Commissioners during the regularly scheduled Commission Conference on December 9, 2019, as noticed by the Commission on November 27, 2019. Participating in the Hearing were:

> Atmos Energy Corporation – A. Scott Ross, Esq., Neal & Harwell, PLC, 1201 Demonbreun St., Ste. 1000, Nashville, TN 37203; and Daniel P. Bertotti, Vice President of Marketing, Kentucky/Mid-States Region, Atmos Energy Corporation, 810 Crescent Centre Drive, Suite 600, Franklin TN 37067.

During the Hearing, Mr. Bertotti ratified, then summarized his Pre-Filed Testimony, and was subject to questioning before the panel. The Commission then invited members of the public to offer comments on this docket, but no one sought recognition to offer comment.

SUMMARY OF AGREEMENT

Atmos provided a copy of the Agreement as Exhibit A to its *Petition*. The significant provisions of the Agreement are summarized as follows:

1. Atmos is supplying interruptible natural gas service to Jack Daniel only, but Jack Daniel may elect to convert to interruptible transportation service with notice.[10]

2. The Maximum Daily Quantity ("MDQ") is defined as 425 Mcf per hour, and 10,200 Mcf per day.[11]

3. The price for interruptible natural gas service is that which is set forth in then-current Rate Schedule 250, or in the case of election to interruptible transportation service, then-current Rate Schedule 260.[12]

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[10] *Petition*, Exh. A, p. 1 (August 14, 2019).
[11] *Id.*
[12] *Id.* at Exh. A, p. 2, 6-7.

4. The term of the Agreement is fifteen (15) years, which may be automatically renewed for up to three (3) consecutive five (5) year terms.[13]

5. The Agreement provides a breakdown of Annual Gross Margin Requirements and specifies volumetric pricing in Appendix A.[14]

6. Jack Daniel agrees to promptly pay any shortfall, plus applicable taxes, if Jack Daniel fails to meet the established Annual Gross Margin Requirement.[15]

7. With regard to calculation of gross margin, each year is calculated individually, with no carryover from prior year(s), if the Annual Gross Margin Requirement is exceeded.[16]

8. Jack Daniel will pay Aid-in-Construction in three installments at the dates and in the amounts set forth in the Agreement.[17]

9. Atmos will construct the extension pipeline, as mapped in the Agreement, commencing by June 1, 2020 and to be completed on or before January 1, 2021.[18]

10. Facilities constructed by Atmos remain the property of Atmos.[19]

11. The Agreement is subject to approval by the Commission.[20]

12. Jack Daniel agrees to exclusively use Atmos for the delivery of its natural gas requirements.[21]

FINDINGS AND CONCLUSIONS

In its *Petition*, Atmos has requested that the Commission approve a special contract pursuant to TPUC Rule 1220-04-01-.07. According to the testimony of the Company witness.

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[13] *Id.* at Exh. A, p. 2.
[14] *Id.* at Exh. A, App. A.
[15] *Id.* at Exh. A, p. 3-4.
[16] *Id.*
[17] *Id.* at Exh. A, p. 3.
[18] *Id.* at Exh. A., p. 2, 4.
[19] *Id.* at Exh. A, p. 4.
[20] *Id.*
[21] *Id.* at Exh. A, p.7

approval is required only because the annual minimum threshold gas consumption requirement could result in a margin recovery payment that would cause a price per Ccf that is higher than that allowed in the Company's tariff. Based on a review and consideration of the *Petition* and its exhibits, the Pre-Filed Testimony and the entire administrative record, the panel made the following findings:

The panel found that Atmos has followed the requirements of the Company's main extension policy set forth in Section 7.1 of the Company's General Rules and Regulations. Specifically, Atmos will bill Jack Daniel's usage based upon the tariff rate providing no discounted rate to Jack Daniel. Further, Atmos conducted a feasibility study to determine the minimum gross margin that would be needed from Jack Daniel on an annual basis during the initial term of the Agreement. Based upon the amounts calculated in the feasibility study, Atmos properly determined that the difference between the margin contributions and the total cost of the project must be recovered by the AIC payments to Atmos established in the Agreement in order to ensure that the Company's other ratepayers are not subsidizing the pipeline extension to Jack Daniel.

In addition, the panel found that the Agreement serves the public interest and provides substantial benefits to Atmos, its ratepayers, and the citizens of Tennessee. The panel determined that the Agreement provides an environmental benefit through Jack Daniel's replacement of woodburning processes with clean natural gas burning processes; a local economic benefit through Jack Daniel's ability to increase future production due to increased efficiency in the distilling process from conversion to natural gas burning processes; and an economic benefit to Atmos ratepayers through potential lower costs to be recovered in future rates due to the increased potential usage by Jack Daniel which offsets more of Atmos's cost of service.

Based upon these findings, the panel concluded that the rates and terms of the Agreement are reasonable. Further, the panel concluded that departure from application of tariff rates is justified under the specific circumstances wherein a non-tariffed rate could be applied. Finally, the panel concluded that the Agreement will benefit Tennessee ratepayers and otherwise serve the public interest. Therefore, the panel unanimously voted to approve the Agreement between Atmos and Jack Daniel to extend the distribution main and provide interruptible service to Jack Daniel.

IT IS THEREFORE ORDERED THAT:

1. The *Petition of Atmos Energy Corporation for Approval of Agreement with Brown-Forman Corporation, d/b/a Jack Daniel* filed on August 14, 2019 is granted.

2. 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.

3. 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.

Commissioner Herbert H. Hilliard, Commissioner John Hie, and Commissioner David F. Jones concur. None dissent.

ATTEST:

Earl Taylor

Earl R. Taylor, Executive Director

Consumer Advocate

Attachment 1-22

Table of Contents

**all excel documents will be emailed electronically in native format to go with this filing.*

PDR 1-22 Attachment-Klein Workpapers ***(tabs: DCF-DWD Firms, CAPM, DCF-Klein Firms, Risk&ROE)***
RiskPremium-Damodaran ***(tabs: Explanations and FAQ, Returns by year, S&P 500 & Raw Data, T. Bond yield & return, T. Bill rates, Inflation Rate, Summary for ppt, Home Prices (Raw Data), Moody's Rates)***
Atmos 8-28-20 VL report
NJR 8-28-20 VL report
NWN 8-28-20 VL report
OneGas 8-28-20 VL report
SJI 8-28-20 VL report
Spire 8-28-20 VL report
SWGas 8-28-20 VL report

DCF
Comparable Firms Data
ValueLine 8/28/20
wsj.com

			Growth Rates				10/29/2020	10/30/2020	11/6/2020	11/9/2020
			Dividends		Earnings		WSJ.com			
Name	**Div Yield**	**Beta**	**Past**	**Forecast**	**Past**	**Forecast**	**Div Yield**	**Div Yield**	**Div Yield**	**Div Yieid**
Atmos	2.4	0.8	6.5	7.5	9.5	7	2.5	2.51	2.46	2.35
New Jersey Resources	3.8	0.9	6.5	6	6	2	4.59	4.56	4.35	3.99
Northwest Natural	3.6	0.8	0.5	1	-17	24.5	4.29	4.32	4.39	4.09
One Gas	3	0.8	17	7.5	9.5	6.5	3.14	3.13	3.04	2.94
South Jersey Industries	5.1	1	6	3.5	-2.5	12.5	6.07	6.11	5.85	5.48
Southwest Gas	3.3	0.9	9.5	4	4.5	9	3.52	3.42	3.39	3.21
Spire	4.3	0.8	5.5	5	9.5	5.5	4.43	4.44	4.35	4.03
Average	3.642857	0.857143	7.357143	4.928571	2.785714	9.571429	4.0771429	4.07	3.975714	3.727143
Mid-point	3.75	0.9	8.75	4.25	-7.5	13.25	4.29	4.32	4.155	3.915

DCF Estimates

Averages			11	8.571429	6.428571	13.21429
Midpoints			12.5	8	-3.75	17

DWD Firms

				Recent Peak Yields			
		Risk Premium		9/9/2020	11/10/2020	CAPM	
Name	**Beta**	**T-Bills**	**T-Bonds**	**Bills**	**Bonds**	**Bills**	**Bonds**
Atmos	0.8	8.18	6.43	0.152	0.979	6.696	6.123
New Jersey Resources	0.9	8.18	6.43	0.152	0.979	7.514	6.766
Northwest Natural	0.8	8.18	6.43	0.152	0.979	6.696	6.123
One Gas	0.8	8.18	6.43	0.152	0.979	6.696	6.123
South Jersey Industries	1	8.18	6.43	0.152	0.979	8.332	7.409
Southwest Gas	0.9	8.18	6.43	0.152	0.979	7.514	6.766
Spire	0.8	8.18	6.43	0.152	0.979	6.696	6.123
Average						7.1634286	6.490428571
Mid-point						7.514	6.653

Klein Firms

				Recent Peak Yields		CAPM		Yields					
		Risk Premium		9/9/2020	11/10/2020	Recent Peak		11/6/2020		11/9/2020		11/13/2020	
Name	**Beta**	**T-Bills**	**T-Bonds**	**Bills**	**Bonds**	**Bills**	**Bonds**	**Bills**	**Bonds**	**Bills**	**Bonds**	**Bills**	**Bonds**
Atmos	0.8	8.18	6.43	0.152	0.979	6.696	6.123	0.129	0.815	0.127	0.935	0.125	0.875
New Jersey Resources	0.9	8.18	6.43	0.152	0.979	7.514	6.766	0.129	0.815	0.127	0.935	0.125	0.875
One Gas	0.8	8.18	6.43	0.152	0.979	6.696	6.123	0.129	0.815	0.127	0.935	0.125	0.875
Southwest Gas	0.9	8.18	6.43	0.152	0.979	7.514	6.766	0.129	0.815	0.127	0.935	0.125	0.875
Spire	0.8	8.18	6.43	0.152	0.979	6.696	6.123	0.129	0.815	0.127	0.935	0.125	0.875
Average						7.0232	6.3802						
Mid-point						7.105	6.3315						

Sources
Beta: ValueLine 8/28/20
Risk Premia: Damodaran
Yields: WSJ.com

				Recent Peak Yields			
		Risk Premium		9/9/2020	11/10/2020	ECAPM	
Name	**Beta**	**T-Bills**	**T-Bonds**	**Bills**	**Bonds**	**Bills**	**Bonds**
Atmos	0.8	8.18	6.43	0.152	0.979	7.105	6.4445
New Jersey Resources	0.9	8.18	6.43	0.152	0.979	7.7185	6.92675

One Gas	0.8	8.18	6.43	0.152	0.979	7.105	6.4445
Southwest Gas	0.9	8.18	6.43	0.152	0.979	7.7185	6.92675
Spire	0.8	8.18	6.43	0.152	0.979	7.105	6.4445
Average						7.3504	6.6374
Mid-point						7.41175	6.685625

Sources
Beta: ValueLine 8/28/20
Risk Premia: Damodaran http://pages.stern.nyu/~adamodar/New-Home-Page/datafile/histretSP.html
Yields: WSJ.com

Comparable Firms Data
ValueLine 8/28/20
wsj.com

Name	Dividend Growth Forecast	10/30/2020 Div Yield	11/9/2020 Div Yield	11/13/2020 Div Yield
Atmos	7.5	2.51	2.35	2.45
New Jersey Resources	6	4.56	3.99	3.65
One Gas	7.5	3.13	2.94	2.83
Southwest Gas	4	3.42	3.21	3.24
Spire	5	4.44	4.03	3.93
Average	6	3.612	3.304	3.22
Mid-point	5.75	3.535	3.19	3.19
DCF Estimates				
Averages		9.612	9.304	9.22
Midpoints		9.285	8.94	8.94

			Growth Rates			
			Dividends		Earnings	
Name	**Div Yield**	**Beta**	**Past**	**Forecast**	**Past**	**Forecast**
Atmos	2.4	0.8	6.5	7.5	9.5	7
New Jersey Resources	3.8	0.9	6.5	6	6	2
One Gas	3	0.8	17	7.5	9.5	6.5
Southwest Gas	3.3	0.9	9.5	4	4.5	9
Spire	4.3	0.8	5.5	5	9.5	5.5
Average	3.36	0.84	9	6	7.8	6
Mid-point	3.75	0.9	8.75	4.25	-7.5	13.25

Reduction in CAPM Cost of Equity for Various Reductions in Risk

5% Risk Reduction
(Proportional Change in Sigma = 0.05)
Risk Premium

		8.18	6.43
	1	0.409	0.3215
Beta	0.9	0.3681	0.28935
	0.8	0.3272	0.2572

10% Risk Reduction
(Proportional Change in Sigma = 0.10)
Risk Premium

		8.18	6.43
	1	0.818	0.643
Beta	0.9	0.7362	0.5787
	0.8	0.6544	0.5144

15% Risk Reduction
(Proportional Change in Sigma = 0.15)
Risk Premium

		8.18	6.43
	1	1.227	0.9645
Beta	0.9	1.1043	0.86805
	0.8	0.9816	0.7716

End Game	My objective in this spreadsheet is to compute the annual returns you would have earned on major financial asset classses, on an annual basis, inclusive of both cash payout during the year and the price appreciation.

Explanations, by asset class	
Stocks (Large Cap)	I use the S&P 500, which was created in 1957, and then back fill the data using other indices of large market cap companies that existed prior. Each year, I compute the dividend yield by dividing the dividends paid by the index at the end of the prior year and then add the price chage in the index, as a percent of the index in the prior year.
US T.Bond	I use the 10-year US treasury bond, since it is the only longer maturity bond with an uninterrupted history going back in time. For the data, I use the yields on a constant-maturrity 10-year bond, which can be found on FRED (the Federal Reserve website). I convert the yield into a return, by repricing the bond, issued at par at the prior year's yield, with the new yield, while keeping the maturity constant at 10 years. Thus, if the yield goes from 2.5% to 3%, I first price a 2.5%, 10 year coupon bond with a 3% interest rate, and subtract this number from the par value of the bond which is $1000. That gives me the price change. Adding the 3% coupon for the current year gives me the total return
US T.Bill	I use the 3-month US treasury bill, again choosing it over the 6-month because of longevity. I get the T.Bill rate at the end of each year from FRED and use it as my erturn, since there should be no price change in this security. I use the average T.Bill rate over the course of the year.
Baa Corporate Bond	I obtain the yield on a Moody's Baa corporate bond from FRED and then compute the return on the bond, using the same approach that I use for the US T.Bond.
Inflation Rate	I use the CPI for all urban consumers, reported on FRED.
Real Returns	For each of the data series. I computre a real return by removing the inflatin for the year from the nominal return, using (1+ Nominal Rate)/ (1+Inflation Rate) -1.
Arithmetic Average Return	A simple average of the annual returns over the specified period (10 yrs, 50 yrs etc.)
Geometric Average Return	A compounded average of the returns over the period. This is most simply computed by dividing the value you would have at the end of the period by the value at the beginning and then computing the compouded average. To compute the cumulated value on both stocks and bonds, I assume that dividends/coupons get reinvested back.
Risk Premium	The risk premium is the difference in the annualized return on stocks and the annualized return on T.Bonds and on T.Bills over the specified period.

FAQ	
How precise are the annual numbers?	Since the S&P and US treasuries are liquid and the underlying data is widely dispersed, the annual numbers are reliable.
How good as the averages as predictors?	The returns, especially on stocks and bonds, are noisy, with up years and down years. The averages that have been computed come with error, and I have computed standard errros in each of the numbers (especially the risk premiums). Note that even with the longest data series, there is substantial standard error and it becomes explosively large for shorter periods.
Why do you keep the maturity of the 10-year bond unchanged, when you compute the return on the bond?	Normally, when you buy a 10-year bond and hold it for a year, you will end up with a 9-year bond. While I could compute the return using a 9-year maturity, and the answer will be fairly close to what I report, I want to keep the 10-year rmaturity going for consistency in my risk premium computation. Put simply, think of the return on the 10-year bond as the one you would have if the coupon changed, but the maturity is reset to 10 year at the end of the year

Date updated:	*1-Jan-20*
Created by:	Aswath Damodaran, adamodar@stern.nyu.edu
What is this dat:	Historical returns: Stocks, Bonds & T.Bills with premi US companies
Home Page:	http://www.damodaran.com
Data website:	http://www.stern.nyu.edu/~adamodar/New_Home_Page/data.html
Companies in ea	http://www.stern.nyu.edu/~adamodar/pc/datasets/indname.xls
Variable definiti	http://www.stern.nyu.edu/~adamodar/New_Home_Page/datafile/variable.htm

Customized Geometric risk premium estimator

What is your riskfree rate?	LT	*Estimates of risk premiums from 1928, over the last 50 years and over the last 10 years*
Enter your starting year	1981	*are provided at the bottom of this table.*
Value of stocks in starting year:	$ 7,934.26	
Value of T.Bills in starting year:	$ 453.46	
Value of T.bonds in starting year:	$ 448.17	
Estimate of risk premium based on your inputs:	3.12%	

	Annual Returns on Investments in				Value of $100 invested at start of 1928 in				Annual Risk Premium					Annual Real Returns on			
Year	S&P 500 (includes dividends)	3-month T.Bill	US T. Bond	Baa Corporate Bond	S&P 500 (includes dividends)3	3-month T.Bill4	US T. Bond5	Baa Corporate Bond6	Stocks - Bills	Stocks - Bonds	Stocks - Baa Corp Bond	Historical risk premium	Inflation Rate	S&P 500 (includes dividends) 2	3-month T. Bill (Real)	10-year T.Bonds	Baa Corp Bonds
1928	43.81%	3.08%	0.84%	3.22%	$ 143.81	$ 103.08	$ 100.84	$ 103.22	40.73%	42.98%	40.59%		-1.15%	45.49%	4.28%	2.01%	4.42%
1929	-8.30%	3.16%	4.20%	3.02%	$ 131.88	$ 106.34	$ 105.07	$ 106.33	-11.46%	-12.50%	-11.32%		0.00%	-8.30%	3.16%	4.20%	3.02%
1930	-25.12%	4.55%	4.54%	0.54%	$ 98.75	$ 111.18	$ 109.85	$ 106.91	-29.67%	-29.66%	-25.66%		-2.67%	-23.07%	7.42%	7.41%	3.30%
1931	-43.84%	2.31%	-2.56%	-15.68%	$ 55.46	$ 113.74	$ 107.03	$ 90.14	-46.15%	-41.28%	-28.16%		-8.93%	-38.33%	12.34%	7.00%	-7.41%
1932	-8.64%	1.07%	8.79%	23.59%	$ 50.66	$ 114.96	$ 116.44	$ 111.41	-9.71%	-17.43%	-32.23%		-10.30%	1.85%	12.68%	21.28%	37.78%
1933	49.98%	0.96%	1.86%	12.97%	$ 75.99	$ 116.06	$ 118.60	$ 125.86	49.02%	48.13%	37.02%		-5.19%	58.20%	6.49%	7.43%	19.15%
1934	-1.19%	0.28%	7.96%	18.82%	$ 75.09	$ 116.39	$ 128.05	$ 149.54	-1.47%	-9.15%	-20.00%		3.48%	-4.51%	-3.09%	4.33%	14.82%
1935	46.74%	0.17%	4.47%	13.31%	$ 110.18	$ 116.58	$ 133.78	$ 169.44	46.57%	42.27%	33.43%		2.55%	43.09%	-2.33%	1.87%	10.49%
1936	31.94%	0.17%	5.02%	11.38%	$ 145.38	$ 116.78	$ 140.49	$ 188.73	31.77%	26.93%	20.56%		1.03%	30.60%	-0.85%	3.94%	10.25%
1937	-35.34%	0.28%	1.38%	-4.42%	$ 94.00	$ 117.11	$ 142.43	$ 180.39	-35.61%	-36.72%	-30.92%		3.73%	-37.66%	-3.33%	-2.26%	-7.85%
1938	29.28%	0.07%	4.21%	9.24%	$ 121.53	$ 117.18	$ 148.43	$ 197.05	29.22%	25.07%	20.05%		-2.03%	31.96%	2.14%	6.37%	11.50%
1939	-1.10%	0.05%	4.41%	7.98%	$ 120.20	$ 117.24	$ 154.98	$ 212.78	-1.14%	-5.51%	-9.08%		-1.30%	0.21%	1.36%	5.79%	9.41%
1940	-10.67%	0.04%	5.40%	8.65%	$ 107.37	$ 117.28	$ 163.35	$ 231.18	-10.71%	-16.08%	-19.32%		0.72%	-11.31%	-0.68%	4.65%	7.87%
1941	-12.77%	0.13%	-2.02%	5.01%	$ 93.66	$ 117.43	$ 160.04	$ 242.76	-12.90%	-10.75%	-17.78%		5.12%	-17.02%	-4.74%	-6.79%	-0.10%
1942	19.17%	0.34%	2.29%	5.18%	$ 111.61	$ 117.83	$ 163.72	$ 255.33	18.83%	16.88%	13.99%		10.92%	7.44%	-9.54%	-7.78%	-5.18%
1943	25.06%	0.38%	2.49%	8.04%	$ 139.59	$ 118.28	$ 167.79	$ 275.88	24.68%	22.57%	17.02%		5.97%	18.02%	-5.27%	-3.28%	1.96%
1944	19.03%	0.38%	2.58%	6.57%	$ 166.15	$ 118.73	$ 172.12	$ 293.99	18.65%	16.45%	12.46%		1.64%	17.11%	-1.24%	0.93%	4.85%
1945	35.82%	0.38%	3.80%	6.80%	$ 225.67	$ 119.18	$ 178.67	$ 313.98	35.44%	32.02%	29.02%		2.27%	32.80%	-1.85%	1.50%	4.43%
1946	-8.43%	0.38%	3.13%	2.51%	$ 206.65	$ 119.63	$ 184.26	$ 321.85	-8.81%	-11.56%	-10.94%		8.48%	-15.58%	-7.46%	-4.93%	-5.50%
1947	5.20%	0.60%	0.92%	0.26%	$ 217.39	$ 120.35	$ 185.95	$ 322.70	4.60%	4.28%	4.94%		14.39%	-8.03%	-12.05%	-11.78%	-12.35%
1948	5.70%	1.05%	1.95%	3.44%	$ 229.79	$ 121.61	$ 189.58	$ 333.79	4.66%	3.75%	2.27%		7.69%	-1.84%	-6.17%	-5.33%	-3.95%
1949	18.30%	1.12%	4.66%	5.38%	$ 271.85	$ 122.96	$ 198.42	$ 351.74	17.19%	13.64%	12.93%		-0.97%	19.46%	2.11%	5.69%	6.41%
1950	30.81%	1.20%	0.43%	4.24%	$ 355.60	$ 124.44	$ 199.27	$ 366.65	29.60%	30.38%	26.57%		1.09%	29.40%	0.12%	-0.65%	3.12%
1951	23.68%	1.52%	-0.30%	-0.19%	$ 439.80	$ 126.33	$ 198.68	$ 365.95	22.16%	23.97%	23.87%		7.86%	14.67%	-5.88%	-7.56%	-7.46%
1952	18.15%	1.72%	2.27%	4.44%	$ 519.62	$ 128.51	$ 203.19	$ 382.20	16.43%	15.88%	13.71%		2.28%	15.52%	-0.54%	-0.01%	2.11%
1953	-1.21%	1.89%	4.14%	1.62%	$ 513.35	$ 130.94	$ 211.61	$ 388.39	-3.10%	-5.35%	-2.83%		0.82%	-2.01%	1.07%	3.30%	0.80%
1954	52.56%	0.94%	3.29%	6.16%	$ 783.18	$ 132.17	$ 218.57	$ 412.31	51.62%	49.27%	46.41%		0.31%	52.09%	0.63%	2.97%	5.83%
1955	32.60%	1.73%	-1.34%	2.04%	$ 1,038.47	$ 134.45	$ 215.65	$ 420.74	30.87%	33.93%	30.55%		-0.28%	32.97%	2.01%	-1.06%	2.33%
1956	7.44%	2.63%	-2.26%	-2.35%	$ 1,115.73	$ 137.98	$ 210.79	$ 410.84	4.81%	9.70%	9.79%		1.53%	5.83%	1.09%	-3.72%	-3.82%
1957	-10.46%	3.23%	6.80%	-0.72%	$ 999.05	$ 142.43	$ 225.11	$ 407.89	-13.68%	-17.25%	-9.74%		3.34%	-13.35%	-0.11%	3.34%	-3.93%

1958	43.72%	1.77%	-2.10%	6.43%	$ 1,435.84	$ 144.95	$ 220.39	$ 434.11	41.95%	45.82%	37.29%		2.73%	39.90%	-0.93%	-4.70%	3.60%
1959	12.06%	3.39%	-2.65%	1.57%	$ 1,608.95	$ 149.86	$ 214.56	$ 440.95	8.67%	14.70%	10.48%		1.01%	10.94%	2.35%	-3.62%	0.56%
1960	0.34%	2.88%	11.64%	6.66%	$ 1,614.37	$ 154.18	$ 239.53	$ 470.33	-2.55%	-11.30%	-6.33%	6.11%	1.46%	-1.11%	1.40%	10.04%	5.13%
1961	26.64%	2.35%	2.06%	5.10%	$ 2,044.40	$ 157.81	$ 244.46	$ 494.32	24.28%	24.58%	21.54%	6.62%	1.07%	25.30%	1.27%	0.98%	3.99%
1962	-8.81%	2.77%	5.69%	6.50%	$ 1,864.26	$ 162.19	$ 258.38	$ 526.43	-11.58%	-14.51%	-15.31%	5.97%	1.20%	-9.89%	1.56%	4.44%	5.23%
1963	22.61%	3.16%	1.68%	5.46%	$ 2,285.80	$ 167.31	$ 262.74	$ 555.19	19.45%	20.93%	17.15%	6.36%	1.24%	21.11%	1.90%	0.44%	4.17%
1964	16.42%	3.55%	3.73%	5.16%	$ 2,661.02	$ 173.25	$ 272.53	$ 583.85	12.87%	12.69%	11.25%	6.53%	1.28%	14.95%	2.24%	2.42%	3.83%
1965	12.40%	3.95%	0.72%	3.19%	$ 2,990.97	$ 180.09	$ 274.49	$ 602.47	8.45%	11.68%	9.21%	6.66%	1.59%	10.65%	2.33%	-0.85%	1.58%
1966	-9.97%	4.86%	2.91%	-3.45%	$ 2,692.74	$ 188.84	$ 282.47	$ 581.72	-14.83%	-12.88%	-6.53%	6.11%	3.02%	-12.61%	1.79%	-0.10%	-6.27%
1967	23.80%	4.31%	-1.58%	0.90%	$ 3,333.69	$ 196.98	$ 278.01	$ 586.92	19.50%	25.38%	22.91%	6.57%	2.77%	20.46%	1.49%	-4.24%	-1.83%
1968	10.81%	5.34%	3.27%	4.85%	$ 3,694.23	$ 207.49	$ 287.11	$ 615.36	5.48%	7.54%	5.97%	6.60%	4.27%	6.28%	1.02%	-0.96%	0.55%
1969	-8.24%	6.67%	-5.01%	-2.03%	$ 3,389.77	$ 221.32	$ 272.71	$ 602.90	-14.91%	-3.23%	-6.22%	6.33%	5.46%	-12.99%	1.14%	-9.93%	-7.10%
1970	3.56%	6.39%	16.75%	5.65%	$ 3,510.49	$ 235.47	$ 318.41	$ 636.96	-2.83%	-13.19%	-2.09%	5.90%	5.84%	-2.15%	0.52%	10.31%	-0.18%
1971	14.22%	4.33%	9.79%	14.00%	$ 4,009.72	$ 245.67	$ 349.57	$ 726.14	9.89%	4.43%	0.22%	5.87%	4.29%	9.52%	0.04%	5.27%	9.31%
1972	18.76%	4.07%	2.82%	11.41%	$ 4,761.76	$ 255.68	$ 359.42	$ 808.99	14.68%	15.94%	7.35%	6.08%	3.27%	14.99%	0.77%	-0.44%	7.88%
1973	-14.31%	7.03%	3.66%	4.32%	$ 4,080.44	$ 273.66	$ 372.57	$ 843.92	-21.34%	-17.97%	-18.63%	5.50%	6.18%	-19.29%	0.80%	-2.37%	-1.75%
1974	-25.90%	7.83%	1.99%	-4.38%	$ 3,023.54	$ 295.08	$ 379.98	$ 806.95	-33.73%	-27.89%	-21.52%	4.64%	11.05%	-33.28%	-2.90%	-8.16%	-13.90%
1975	37.00%	5.78%	3.61%	11.05%	$ 4,142.10	$ 312.12	$ 393.68	$ 896.12	31.22%	33.39%	25.95%	5.17%	9.14%	25.52%	-3.09%	-5.07%	1.75%
1976	23.83%	4.97%	15.98%	19.75%	$ 5,129.20	$ 327.65	$ 456.61	$ 1,073.13	18.86%	7.85%	4.08%	5.22%	5.74%	17.10%	-0.73%	9.68%	13.25%
1977	-6.98%	5.27%	1.29%	9.95%	$ 4,771.20	$ 344.91	$ 462.50	$ 1,179.96	-12.25%	-8.27%	-16.93%	4.93%	6.50%	-12.66%	-1.16%	-4.89%	3.24%
1978	6.51%	7.19%	-0.78%	3.14%	$ 5,081.77	$ 369.71	$ 458.90	$ 1,216.98	-0.68%	7.29%	3.37%	4.97%	7.63%	-1.04%	-0.41%	-7.81%	-4.17%
1979	18.52%	10.07%	0.67%	-2.01%	$ 6,022.89	$ 406.93	$ 461.98	$ 1,192.53	8.45%	17.85%	20.53%	5.21%	11.25%	6.53%	-1.07%	-9.51%	-11.92%
1980	31.74%	11.43%	-2.99%	-3.32%	$ 7,934.26	$ 453.46	$ 448.17	$ 1,152.99	20.30%	34.72%	35.05%	5.73%	13.55%	16.02%	-1.86%	-14.57%	-14.85%
1981	-4.70%	14.03%	8.20%	8.46%	$ 7,561.16	$ 517.06	$ 484.91	$ 1,250.56	-18.73%	-12.90%	-13.16%	5.37%	10.33%	-13.63%	3.34%	-1.94%	-1.70%
1982	20.42%	10.61%	32.81%	29.05%	$ 9,105.08	$ 571.94	$ 644.04	$ 1,613.88	9.80%	-12.40%	-8.63%	5.10%	6.13%	13.46%	4.22%	25.14%	21.60%
1983	22.34%	8.61%	3.20%	16.19%	$ 11,138.90	$ 621.19	$ 664.65	$ 1,875.23	13.73%	19.14%	6.14%	5.34%	3.21%	18.53%	5.23%	-0.01%	12.58%
1984	6.15%	9.52%	13.73%	15.62%	$ 11,823.51	$ 680.35	$ 755.92	$ 2,168.13	-3.38%	-7.59%	-9.47%	5.12%	4.30%	1.77%	5.01%	9.04%	10.85%
1985	31.24%	7.48%	25.71%	23.86%	$ 15,516.60	$ 731.23	$ 950.29	$ 2,685.50	23.76%	5.52%	7.37%	5.13%	3.55%	26.74%	3.80%	21.41%	19.62%
1986	18.49%	5.98%	24.28%	21.49%	$ 18,386.33	$ 774.95	$1,181.06	$ 3,262.50	12.52%	-5.79%	-2.99%	4.97%	1.90%	16.29%	4.00%	21.97%	19.22%
1987	5.81%	5.78%	-4.96%	2.29%	$ 19,455.08	$ 819.70	$1,122.47	$ 3,337.20	0.04%	10.77%	3.52%	5.07%	3.66%	2.07%	2.04%	-8.32%	-1.33%
1988	16.54%	6.67%	8.22%	15.12%	$ 22,672.40	$ 874.35	$1,214.78	$ 3,841.62	9.87%	8.31%	1.42%	5.12%	4.08%	11.97%	2.49%	3.98%	10.60%
1989	31.48%	8.11%	17.69%	15.79%	$ 29,808.58	$ 945.28	$1,429.72	$ 4,448.20	23.36%	13.78%	15.69%	5.24%	4.83%	25.42%	3.13%	12.27%	10.46%
1990	-3.06%	7.49%	6.24%	6.14%	$ 28,895.11	$ 1,016.11	$1,518.87	$ 4,721.33	-10.56%	-9.30%	-9.20%	5.00%	5.40%	-8.03%	1.99%	0.79%	0.70%
1991	30.23%	5.38%	15.00%	17.85%	$ 37,631.51	$ 1,070.73	$1,746.77	$ 5,564.25	24.86%	15.23%	12.38%	5.14%	4.23%	24.94%	1.09%	10.33%	13.07%
1992	7.49%	3.43%	9.36%	12.17%	$ 40,451.51	$ 1,107.47	$1,910.30	$ 6,241.54	4.06%	-1.87%	-4.68%	5.03%	3.03%	4.33%	0.39%	6.15%	8.87%
1993	9.97%	3.00%	14.21%	16.43%	$ 44,483.33	$ 1,140.67	$2,181.77	$ 7,267.12	6.97%	-4.24%	-6.46%	4.90%	2.95%	6.81%	0.04%	10.94%	13.09%
1994	1.33%	4.25%	-8.04%	-1.32%	$ 45,073.14	$ 1,189.11	$2,006.43	$ 7,171.25	-2.92%	9.36%	2.65%	4.97%	2.61%	-1.25%	1.60%	-10.37%	-3.83%
1995	37.20%	5.49%	23.48%	20.16%	$ 61,838.19	$ 1,254.39	$2,477.55	$ 8,616.71	31.71%	13.71%	17.04%	5.08%	2.81%	33.45%	2.61%	20.11%	16.88%
1996	22.68%	5.01%	1.43%	4.79%	$ 75,863.69	$ 1,317.18	$2,512.94	$ 9,029.67	17.68%	21.25%	17.89%	5.30%	2.93%	19.19%	2.02%	-1.46%	1.81%
1997	33.10%	5.06%	9.94%	11.83%	$100,977.34	$ 1,383.84	$2,762.71	$10,098.32	28.04%	23.16%	21.27%	5.53%	2.34%	30.06%	2.66%	7.43%	9.28%
1998	28.34%	4.78%	14.92%	7.95%	$129,592.25	$ 1,449.94	$3,174.95	$10,900.68	23.56%	13.42%	20.39%	5.63%	1.55%	26.38%	3.18%	13.16%	6.30%
1999	20.89%	4.64%	-8.25%	0.84%	$156,658.05	$ 1,517.20	$2,912.88	$10,992.59	16.25%	29.14%	20.04%	5.96%	2.19%	18.30%	2.40%	-10.22%	-1.32%
2000	-9.03%	5.82%	16.66%	9.33%	$142,508.98	$ 1,605.45	$3,398.03	$12,018.16	-14.85%	-25.69%	-18.36%	5.51%	3.38%	-12.00%	2.36%	12.84%	5.76%
2001	-11.85%	3.39%	5.57%	7.82%	$125,622.01	$ 1,659.84	$3,587.37	$12,957.88	-15.24%	-17.42%	-19.67%	5.17%	2.83%	-14.27%	0.55%	2.67%	4.86%
2002	-21.97%	1.60%	15.12%	12.18%	$ 98,027.82	$ 1,686.44	$4,129.65	$14,535.88	-23.57%	-37.08%	-34.14%	4.53%	1.59%	-23.18%	0.02%	13.32%	10.43%
2003	28.36%	1.01%	0.38%	13.53%	$125,824.39	$ 1,703.49	$4,145.15	$16,502.87	27.34%	27.98%	14.82%	4.82%	2.27%	25.51%	-1.23%	-1.85%	11.01%
2004	10.74%	1.37%	4.49%	9.89%	$139,341.42	$ 1,726.86	$4,331.30	$18,134.78	9.37%	6.25%	0.85%	4.84%	2.68%	7.86%	-1.27%	1.77%	7.02%
2005	4.83%	3.15%	2.87%	4.92%	$146,077.85	$ 1,781.19	$4,455.50	$19,026.57	1.69%	1.97%	-0.08%	4.80%	3.39%	1.39%	-0.24%	-0.51%	1.47%
2006	15.61%	4.73%	1.96%	7.05%	$168,884.34	$ 1,865.39	$4,542.87	$20,367.63	10.89%	13.65%	8.56%	4.91%	3.23%	12.00%	1.45%	-1.23%	3.70%
2007	5.48%	4.35%	10.21%	3.15%	$178,147.20	$ 1,946.59	$5,006.69	$21,009.29	1.13%	-4.73%	2.33%	4.79%	2.85%	2.56%	1.46%	7.15%	0.29%
2008	-36.55%	1.37%	20.10%	-5.07%	$113,030.22	$ 1,973.16	$6,013.10	$19,945.02	-37.92%	-56.65%	-31.49%	3.88%	3.84%	-38.90%	-2.38%	15.66%	-8.58%
2009	25.94%	0.15%	-11.12%	23.33%	$142,344.87	$ 1,976.12	$5,344.65	$24,598.10	25.79%	37.05%	2.61%	4.29%	-0.36%	26.38%	0.51%	-10.80%	23.77%
2010	14.82%	0.14%	8.46%	8.35%	$163,441.94	$ 1,978.82	$5,796.96	$26,651.51	14.68%	6.36%	6.47%	4.31%	1.64%	12.97%	-1.48%	6.71%	6.60%
2011	2.10%	0.05%	16.04%	12.58%	$166,871.56	$ 1,979.86	$6,726.52	$30,005.47	2.05%	-13.94%	-10.49%	4.10%	3.16%	-1.03%	-3.01%	12.48%	9.14%

2012	15.89%	0.09%	2.97%	10.12%	$193,388.43	$ 1,981.56	$6,926.40	$33,043.43	15.80%	12.92%	5.77%	4.20%	2.07%	13.54%	-1.94%	0.88%	7.89%
2013	32.15%	0.06%	-9.10%	-1.06%	$255,553.31	$ 1,982.72	$6,295.79	$32,694.52	32.09%	41.25%	33.20%	4.62%	1.46%	30.24%	-1.39%	-10.42%	-2.48%
2014	13.52%	0.03%	10.75%	10.38%	$290,115.42	$ 1,983.36	$6,972.34	$36,089.82	13.49%	2.78%	3.14%	4.60%	1.62%	11.71%	-1.56%	8.98%	8.62%
2015	1.38%	0.05%	1.28%	-0.70%	$294,115.79	$ 1,984.40	$7,061.89	$35,838.08	1.33%	0.09%	2.08%	4.54%	0.12%	1.26%	-0.07%	1.16%	-0.82%
2016	11.77%	0.32%	0.69%	10.37%	$328,742.28	$ 1,990.70	$7,110.65	$39,552.74	11.46%	11.08%	1.41%	4.62%	1.26%	10.38%	-0.93%	-0.56%	8.99%
2017	21.61%	0.93%	2.80%	9.72%	$399,768.64	$ 2,009.23	$7,309.87	$43,398.81	20.67%	18.80%	11.88%	4.77%	2.13%	19.07%	-1.17%	0.66%	7.44%
2018	-4.23%	1.94%	-0.02%	-2.76%	$382,870.94	$ 2,048.20	$7,308.65	$42,199.86	-6.17%	-4.21%	-1.46%	4.66%	2.44%	-6.51%	-0.49%	-2.40%	-5.08%
2019	31.22%	1.55%	9.64%	15.33%	$502,417.21	$ 2,079.94	$8,012.89	$48,668.87	29.67%	21.59%	15.89%	4.83%	2.29%	28.29%	-0.72%	7.18%	12.75%
							Risk Premium		***Standard Error***								
Arithmetic Average Historical Return							Stocks - T.B	Stocks - T.Bo	Stocks - T.Bil	Stocks - T.Bonds			**Arithmetic Average Annual Real Return**				
1928-2019	11.57%	3.40%	5.15%	7.22%			8.18%	6.43%	2.08%	2.20%			1928-2018	8.41%	0.43%	2.17%	4.22%
1970-2019	11.89%	4.64%	7.39%	9.46%			7.26%	4.50%	2.38%	2.73%			1969-2018	6.88%	0.65%	2.99%	4.97%
2010-2019	14.02%	0.52%	4.35%	7.23%			13.51%	9.67%	3.85%	4.87%			2009-2018	11.80%	-1.15%	0.67%	6.41%
								Risk Premium									
Geometric Average Historical Return							Stocks - T.B	Stocks - T.Bonds									
1928-2019	9.71%	3.35%	4.88%	6.96%			6.35%	4.83%									
1970-2019	10.51%	4.58%	6.99%	9.18%			5.93%	3.52%									
2010-2019	13.44%	0.51%	4.13%	7.06%			12.93%	9.31%									

Year	S&P 500	Dividends	)ividend Yiel	T.Bond rate	eturn on bor	aa Bond Ra	eturn on Aa	aa Bond Ra	eturn on Ba	ns on Real Estate		Jan 1 notes	
1927	17.66	0.62	3.50%	3.17%		4.46%		5.32%					
1928	24.35	1.05	4.30%	3.45%	0.84%	4.61%	3.28%	5.60%	3.22%	1.49%			
1929	21.45	0.88	4.10%	3.36%	4.20%	4.67%	4.14%	5.95%	3.02%	-2.06%			
1930	15.34	0.72	4.70%	3.22%	4.54%	4.52%	5.86%	6.71%	0.54%	-4.30%			
1931	8.12	0.50	6.10%	3.93%	-2.56%	5.32%	-1.56%	10.42%	-15.68%	-8.15%			
1932	6.92	0.50	7.20%	3.35%	8.79%	4.59%	11.07%	8.42%	23.59%	-10.47%			
1933	9.97	0.41	4.10%	3.53%	1.86%	4.50%	5.30%	7.75%	12.97%	-3.81%			
1934	9.5	0.35	3.70%	3.01%	7.96%	3.81%	10.15%	6.23%	18.82%	2.91%			
1935	13.43	0.51	3.80%	2.84%	4.47%	3.44%	6.90%	5.30%	13.31%	9.77%			
1936	17.18	0.54	3.14%	2.59%	5.02%	3.10%	6.33%	4.53%	11.38%	3.22%			
1937	10.55	0.56	5.30%	2.73%	1.38%	3.21%	2.17%	5.73%	-4.42%	2.56%			
1938	13.14	0.50	3.80%	2.56%	4.21%	3.08%	4.31%	5.27%	9.24%	-0.87%			
1939	12.46	0.54	4.30%	2.35%	4.41%	2.94%	4.28%	4.92%	7.98%	-1.30%			
1940	10.58	0.55	5.20%	2.01%	5.40%	2.71%	4.93%	4.45%	8.65%	3.31%			
1941	8.69	0.54	6.20%	2.47%	-2.02%	2.80%	1.93%	4.38%	5.01%	-8.38%			
1942	9.77	0.59	6.00%	2.49%	2.29%	2.81%	2.71%	4.28%	5.18%	3.33%			
1943	11.67	0.55	4.70%	2.49%	2.49%	2.74%	3.42%	3.82%	8.04%	11.45%			
1944	13.28	0.61	4.60%	2.48%	2.58%	2.70%	3.09%	3.49%	6.57%	16.58%			
1945	17.36	0.68	3.90%	2.33%	3.80%	2.61%	3.48%	3.10%	6.80%	11.78%			
1946	15.3	0.60	3.90%	2.24%	3.13%	2.61%	2.61%	3.17%	2.51%	24.10%			
1947	15.3	0.80	5.20%	2.39%	0.92%	2.86%	0.46%	3.52%	0.26%	21.26%			
1948	15.2	0.97	6.40%	2.44%	1.95%	2.79%	3.46%	3.53%	3.44%	2.06%			
1949	16.79	1.19	7.10%	2.19%	4.66%	2.58%	4.62%	3.31%	5.38%	0.09%			
1950	20.43	1.53	7.50%	2.39%	0.43%	2.67%	1.80%	3.20%	4.24%	3.64%			
1951	23.77	1.50	6.30%	2.70%	-0.30%	3.01%	-0.23%	3.61%	-0.19%	6.05%			
1952	26.57	1.51	5.70%	2.75%	2.27%	2.97%	3.35%	3.51%	4.44%	4.41%			
1953	24.81	1.44	5.80%	2.59%	4.14%	3.13%	1.61%	3.74%	1.62%	11.52%			
1954	35.98	1.87	5.20%	2.51%	3.29%	2.90%	5.10%	3.45%	6.16%	0.92%			
1955	45.48	2.23	4.90%	2.96%	-1.34%	3.15%	0.78%	3.62%	2.04%	0.00%			
1956	46.67	2.19	4.70%	3.59%	-2.26%	3.75%	-1.78%	4.37%	-2.35%	0.91%			
1957	39.99	1.80	4.50%	3.21%	6.80%	3.81%	3.26%	5.03%	-0.72%	2.72%			
1958	55.21	2.26	4.10%	3.86%	-2.10%	4.08%	1.63%	4.85%	6.43%	0.66%			
1959	59.89	1.98	3.30%	4.69%	-2.65%	4.58%	0.14%	5.28%	1.57%	0.11%			
1960	58.11	1.98	3.41%	3.84%	11.64%	4.35%	6.41%	5.10%	6.66%	0.77%			
1961	71.55	2.04	2.85%	4.06%	2.06%	4.42%	3.79%	5.10%	5.10%	0.98%			
1962	63.1	2.15	3.40%	3.86%	5.69%	4.24%	5.86%	4.92%	6.50%	0.32%			

1963	75.02	2.35	3.13%	4.13%	1.68%	4.35%	3.36%	4.85%	5.46%	2.14%			
1964	84.75	2.58	3.05%	4.18%	3.73%	4.44%	3.64%	4.81%	5.16%	1.26%			
1965	92.43	2.83	3.06%	4.62%	0.72%	4.68%	2.56%	5.02%	3.19%	1.66%			
1966	80.33	2.88	3.59%	4.84%	2.91%	5.39%	-0.70%	6.18%	-3.45%	1.22%			
1967	96.47	2.98	3.09%	5.70%	-1.58%	6.19%	-0.45%	6.93%	0.90%	2.32%			
1968	103.86	3.04	2.93%	6.03%	3.27%	6.45%	4.32%	7.23%	4.85%	4.13%			
1969	92.06	3.24	3.52%	7.65%	-5.01%	7.72%	-2.18%	8.65%	-2.03%	6.99%			
1970	92.15	3.19	3.46%	6.39%	16.75%	7.64%	8.27%	9.12%	5.65%	8.22%			
1971	102.09	3.16	3.10%	5.93%	9.79%	7.25%	10.35%	8.38%	14.00%	4.24%			
1972	118.05	3.19	2.70%	6.36%	2.82%	7.08%	8.44%	7.93%	11.41%	2.98%			
1973	97.55	3.61	3.70%	6.74%	3.66%	7.68%	3.00%	8.48%	4.32%	3.42%			
1974	68.56	3.72	5.43%	7.43%	1.99%	8.89%	-0.12%	10.63%	-4.38%	10.07%			
1975	90.19	3.73	4.14%	8.00%	3.61%	8.79%	9.54%	10.56%	11.05%	6.76%			
1976	107.46	4.22	3.93%	6.87%	15.98%	7.98%	14.23%	9.12%	19.75%	8.20%			
1977	95.1	4.86	5.11%	7.69%	1.29%	8.19%	6.58%	8.99%	9.95%	14.66%			
1978	96.11	5.18	5.39%	9.01%	-0.78%	9.16%	2.01%	9.94%	3.14%	15.71%			
1979	107.94	5.97	5.53%	10.39%	0.67%	10.74%	-0.25%	12.06%	-2.01%	13.74%			
1980	135.76	6.44	4.74%	12.84%	-2.99%	13.21%	-2.55%	15.14%	-3.32%	7.40%			
1981	122.55	6.83	5.57%	13.72%	8.20%	14.23%	7.94%	16.55%	8.46%	5.08%			
1982	140.64	6.93	4.93%	10.54%	32.81%	11.83%	27.89%	14.14%	29.05%	0.57%			
1983	164.93	7.12	4.32%	11.83%	3.20%	12.57%	7.74%	13.75%	16.19%	4.75%			
1984	167.24	7.83	4.68%	11.50%	13.73%	12.13%	15.04%	13.40%	15.62%	4.67%			
1985	211.28	8.20	3.88%	9.26%	25.71%	10.16%	24.15%	11.58%	23.86%	7.47%			
1986	242.17	8.19	3.38%	7.11%	24.28%	8.49%	21.12%	9.97%	21.49%	9.62%			
1987	247.08	9.17	3.71%	8.99%	-4.96%	10.11%	-1.42%	11.29%	2.29%	7.87%			
1988	277.72	10.22	3.68%	9.11%	8.22%	9.57%	13.49%	10.65%	15.12%	7.21%			
1989	353.4	11.73	3.32%	7.84%	17.69%	8.86%	14.15%	9.82%	15.79%	4.38%			
1990	330.22	12.35	3.74%	8.08%	6.24%	9.05%	7.64%	10.43%	6.14%	-0.70%			
1991	417.09	12.97	3.11%	7.09%	15.00%	8.31%	13.95%	9.26%	17.85%	-0.18%			
1992	435.71	12.64	2.90%	6.77%	9.36%	7.98%	10.53%	8.81%	12.17%	0.84%			
1993	466.45	12.69	2.72%	5.77%	14.21%	6.93%	15.38%	7.69%	16.43%	2.16%			
1994	459.27	13.36	2.91%	7.81%	-8.04%	8.46%	-3.13%	9.10%	-1.32%	2.52%			
1995	615.93	14.17	2.30%	5.71%	23.48%	6.82%	20.08%	7.49%	20.16%	1.81%			
1996	740.74	14.89	2.01%	6.30%	1.43%	7.20%	4.18%	7.89%	4.79%	2.43%			
1997	970.43	15.52	1.60%	5.81%	9.94%	6.76%	10.32%	7.32%	11.83%	4.03%			
1998	1229.23	16.20	1.32%	4.65%	14.92%	6.22%	10.69%	7.23%	7.95%	6.44%			
1999	1469.25	16.71	1.14%	6.44%	-8.25%	7.55%	-2.89%	8.19%	0.84%	7.69%			
2000	1320.28	16.27	1.23%	5.11%	16.66%	7.21%	9.92%	8.02%	9.33%	9.25%			

2001	1148.09	15.74	1.37%	5.05%	5.57%	6.77%	10.33%	8.05%	7.82%	6.68%			
2002	879.82	16.08	1.83%	3.82%	15.12%	6.21%	10.85%	7.45%	12.18%	9.56%			
2003	1111.91	17.39	1.56%	4.25%	0.38%	5.62%	10.63%	6.60%	13.53%	9.82%			
2004	1211.92	19.44	1.60%	4.22%	4.49%	5.47%	6.75%	6.15%	9.89%	13.64%			
2005	1248.29	22.22	1.78%	4.39%	2.87%	5.37%	6.23%	6.32%	4.92%	13.51%			
2006	1418.3	24.88	1.75%	4.70%	1.96%	5.32%	5.75%	6.22%	7.05%	1.73%			
2007	1468.36	27.73	1.89%	4.02%	10.21%	5.49%	4.04%	6.65%	3.15%	-5.40%			
2008	903.25	28.39	3.14%	2.21%	20.10%	5.05%	8.88%	8.43%	-5.07%	-12.00%			
2009	1115.1	22.41	2.01%	3.84%	-11.12%	5.26%	3.45%	6.37%	23.33%	-3.85%			
2010	1257.64	22.73	1.81%	3.29%	8.46%	5.02%	7.11%	6.10%	8.35%	-4.12%			
2011	1257.6	26.43	2.10%	1.88%	16.04%	3.93%	13.89%	5.25%	12.58%	-3.90%			
2012	1426.19	31.25	2.19%	1.76%	2.97%	3.65%	6.24%	4.63%	10.12%	6.45%			
2013	1848.36	36.28	1.96%	3.04%	-9.10%	4.62%	-3.98%	5.38%	-1.06%	10.71%			
2014	2058.9	39.44	1.92%	2.17%	10.75%	3.79%	11.42%	4.74%	10.38%	4.52%			
2015	2043.9	43.39	2.12%	2.27%	1.28%	3.97%	2.33%	5.46%	-0.70%	5.22%			
2016	2238.83	45.70	2.04%	2.45%	0.69%	4.06%	3.24%	4.83%	10.37%	5.33%			
2017	2673.61	48.93	1.83%	2.41%	2.80%	3.51%	8.63%	4.22%	9.72%	6.23%			
2018	2506.85	53.75	2.14%	2.69%	-0.02%	4.02%	-0.62%	5.13%	-2.76%	4.55%			
2019	3230.78	58.8	1.82%	1.92%	9.64%	3.01%	12.63%	3.88%	15.33%	4.55%		Used indicated dividend	

Bond used:	US treasury 10-year bond at end of each year	
Source:	Federal Reserve of St. Louis (FRED)	
Computation	To compute the return on a constant maturity bond, I add two components - the promised coupon at the start of the year and the price change due to interest rate changes.	
	The return on the 10-year bond for 1928 = 3.17% (Coupon rate promised at the end of 1927) - Price change on a bond with a coupon rate of 3.17%, when the interest rate goes to 3.45%.	
Year	T.Bond rate	eturn on bond
1927	3.17%	
1928	3.45%	0.84%
1929	3.36%	4.20%
1930	3.22%	4.54%
1931	3.93%	-2.56%
1932	3.35%	8.79%
1933	3.53%	1.86%
1934	3.01%	7.96%
1935	2.84%	4.47%
1936	2.59%	5.02%
1937	2.73%	1.38%
1938	2.56%	4.21%
1939	2.35%	4.41%
1940	2.01%	5.40%
1941	2.47%	-2.02%
1942	2.49%	2.29%
1943	2.49%	2.49%
1944	2.48%	2.58%
1945	2.33%	3.80%
1946	2.24%	3.13%
1947	2.39%	0.92%
1948	2.44%	1.95%
1949	2.19%	4.66%
1950	2.39%	0.43%
1951	2.70%	-0.30%
1952	2.75%	2.27%
1953	2.59%	4.14%
1954	2.51%	3.29%
1955	2.96%	-1.34%
1956	3.59%	-2.26%
1957	3.21%	6.80%
1958	3.86%	-2.10%
1959	4.69%	-2.65%
1960	3.84%	11.64%
1961	4.06%	2.06%
1962	3.86%	5.69%
1963	4.13%	1.68%

1964	4.18%	3.73%														
1965	4.62%	0.72%														
1966	4.84%	2.91%														
1967	5.70%	-1.58%														
1968	6.03%	3.27%														
1969	7.65%	-5.01%														
1970	6.39%	16.75%														
1971	5.93%	9.79%														
1972	6.36%	2.82%														
1973	6.74%	3.66%														
1974	7.43%	1.99%														
1975	8.00%	3.61%														
1976	6.87%	15.98%														
1977	7.69%	1.29%														
1978	9.01%	-0.78%														
1979	10.39%	0.67%														
1980	12.84%	-2.99%														
1981	13.72%	8.20%														
1982	10.54%	32.81%														
1983	11.83%	3.20%														
1984	11.50%	13.73%														
1985	9.26%	25.71%														
1986	7.11%	24.28%														
1987	8.99%	-4.96%														
1988	9.11%	8.22%														
1989	7.84%	17.69%														
1990	8.08%	6.24%														
1991	7.09%	15.00%														
1992	6.77%	9.36%														
1993	5.77%	14.21%														
1994	7.81%	-8.04%														
1995	5.71%	23.48%														
1996	6.30%	1.43%														
1997	5.81%	9.94%														
1998	4.65%	14.92%														
1999	6.44%	-8.25%														
2000	5.11%	16.66%														
2001	5.05%	5.57%														
2002	3.82%	15.12%														
2003	4.25%	0.38%														
2004	4.22%	4.49%														
2005	4.39%	2.87%														
2006	4.70%	1.96%														
2007	4.02%	10.21%														

2008	2.21%	20.10%													
2009	3.84%	-11.12%													
2010	3.29%	8.46%													
2011	1.88%	16.04%													
2012	1.76%	2.97%													
2013	3.04%	-9.10%													
2014	2.17%	10.75%													
2015	2.27%	1.28%													
2016	2.45%	0.69%													
2017	2.41%	2.80%													
2018	2.69%	-0.02%													
2019	1.92%	9.64%													

FRED Graph Observations			
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TB3MS	3-Month Treasury Bill: Secondary Market Rate, Percent, Annual, Not Seasonally Adjusted		
Frequency: Annual			
observation_date	TB3MS		
1934-01-01	0.28	0.28%	
1935-01-01	0.17	0.17%	
1936-01-01	0.17	0.17%	
1937-01-01	0.28	0.28%	
1938-01-01	0.07	0.07%	
1939-01-01	0.05	0.05%	
1940-01-01	0.04	0.04%	
1941-01-01	0.13	0.13%	
1942-01-01	0.34	0.34%	
1943-01-01	0.38	0.38%	
1944-01-01	0.38	0.38%	
1945-01-01	0.38	0.38%	
1946-01-01	0.38	0.38%	
1947-01-01	0.60	0.60%	
1948-01-01	1.05	1.05%	
1949-01-01	1.12	1.12%	
1950-01-01	1.20	1.20%	
1951-01-01	1.52	1.52%	
1952-01-01	1.72	1.72%	
1953-01-01	1.89	1.89%	
1954-01-01	0.94	0.94%	
1955-01-01	1.73	1.73%	
1956-01-01	2.63	2.63%	
1957-01-01	3.23	3.23%	
1958-01-01	1.77	1.77%	
1959-01-01	3.39	3.39%	

1960-01-01	2.88	2.88%	
1961-01-01	2.35	2.35%	
1962-01-01	2.77	2.77%	
1963-01-01	3.16	3.16%	
1964-01-01	3.55	3.55%	
1965-01-01	3.95	3.95%	
1966-01-01	4.86	4.86%	
1967-01-01	4.31	4.31%	
1968-01-01	5.34	5.34%	
1969-01-01	6.67	6.67%	
1970-01-01	6.39	6.39%	
1971-01-01	4.33	4.33%	
1972-01-01	4.07	4.07%	
1973-01-01	7.03	7.03%	
1974-01-01	7.83	7.83%	
1975-01-01	5.78	5.78%	
1976-01-01	4.97	4.97%	
1977-01-01	5.27	5.27%	
1978-01-01	7.19	7.19%	
1979-01-01	10.07	10.07%	
1980-01-01	11.43	11.43%	
1981-01-01	14.03	14.03%	
1982-01-01	10.61	10.61%	
1983-01-01	8.61	8.61%	
1984-01-01	9.52	9.52%	
1985-01-01	7.48	7.48%	
1986-01-01	5.98	5.98%	
1987-01-01	5.78	5.78%	
1988-01-01	6.67	6.67%	
1989-01-01	8.11	8.11%	
1990-01-01	7.49	7.49%	
1991-01-01	5.38	5.38%	
1992-01-01	3.43	3.43%	
1993-01-01	3.00	3.00%	
1994-01-01	4.25	4.25%	
1995-01-01	5.49	5.49%	
1996-01-01	5.01	5.01%	

T. Bill rates

1997-01-01	5.06	5.06%	
1998-01-01	4.78	4.78%	
1999-01-01	4.64	4.64%	
2000-01-01	5.82	5.82%	
2001-01-01	3.39	3.39%	
2002-01-01	1.60	1.60%	
2003-01-01	1.01	1.01%	
2004-01-01	1.37	1.37%	
2005-01-01	3.15	3.15%	
2006-01-01	4.73	4.73%	
2007-01-01	4.35	4.35%	
2008-01-01	1.37	1.37%	
2009-01-01	0.15	0.15%	
2010-01-01	0.14	0.14%	
2011-01-01	0.05	0.05%	
2012-01-01	0.09	0.09%	
2013-01-01	0.06	0.06%	
2014-01-01	0.03	0.03%	
2015-01-01	0.05	0.05%	
2016-01-01	0.32	0.32%	
2017-01-01	0.93	0.93%	
2018-01-01	1.94	1.94%	
2019-01-01	2.06	2.06%	
1/1/2020	1.52	1.52%	

FRED Graph Observations		
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Economic Research Division		
Federal Reserve Bank of St. Louis		
CPIAUCNS	Consumer Price Index for All Urban Consumers: All Items in U.S. City Average, Percent Change from Year Ago of (Index 1982-1984=100), Annual, Not Seasonally Adjusted	
Frequency: Annual		
observation_d	CPIAUCNS	
1914-01-01	1.3	1.35%
1915-01-01	0.9	0.92%
1916-01-01	7.7	7.67%
1917-01-01	17.8	17.84%
1918-01-01	17.3	17.28%
1919-01-01	15.2	15.24%
1920-01-01	15.6	15.63%
1921-01-01	-10.9	-10.94%
1922-01-01	-6.2	-6.16%
1923-01-01	1.8	1.79%
1924-01-01	0.4	0.44%
1925-01-01	2.4	2.43%
1926-01-01	0.9	0.90%
1927-01-01	-1.9	-1.93%
1928-01-01	-1.2	-1.15%
1929-01-01	0.0	0.00%
1930-01-01	-2.7	-2.67%
1931-01-01	-8.9	-8.93%
1932-01-01	-10.3	-10.30%
1933-01-01	-5.2	-5.19%
1934-01-01	3.5	3.48%
1935-01-01	2.6	2.55%
1936-01-01	1.0	1.03%
1937-01-01	3.7	3.73%
1938-01-01	-2.0	-2.03%
1939-01-01	-1.3	-1.30%
1940-01-01	0.7	0.72%
1941-01-01	5.1	5.12%
1942-01-01	10.9	10.92%
1943-01-01	6.0	5.97%
1944-01-01	1.6	1.64%
1945-01-01	2.3	2.27%
1946-01-01	8.5	8.48%
1947-01-01	14.4	14.39%
1948-01-01	7.7	7.69%
1949-01-01	-1.0	-0.97%
1950-01-01	1.1	1.09%

1951-01-01	7.9	7.86%
1952-01-01	2.3	2.28%
1953-01-01	0.8	0.82%
1954-01-01	0.3	0.31%
1955-01-01	-0.3	-0.28%
1956-01-01	1.5	1.53%
1957-01-01	3.3	3.34%
1958-01-01	2.7	2.73%
1959-01-01	1.0	1.01%
1960-01-01	1.5	1.46%
1961-01-01	1.1	1.07%
1962-01-01	1.2	1.20%
1963-01-01	1.2	1.24%
1964-01-01	1.3	1.28%
1965-01-01	1.6	1.59%
1966-01-01	3.0	3.02%
1967-01-01	2.8	2.77%
1968-01-01	4.3	4.27%
1969-01-01	5.5	5.46%
1970-01-01	5.8	5.84%
1971-01-01	4.3	4.29%
1972-01-01	3.3	3.27%
1973-01-01	6.2	6.18%
1974-01-01	11.1	11.05%
1975-01-01	9.1	9.14%
1976-01-01	5.7	5.74%
1977-01-01	6.5	6.50%
1978-01-01	7.6	7.63%
1979-01-01	11.3	11.25%
1980-01-01	13.5	13.55%
1981-01-01	10.3	10.33%
1982-01-01	6.1	6.13%
1983-01-01	3.2	3.21%
1984-01-01	4.3	4.30%
1985-01-01	3.5	3.55%
1986-01-01	1.9	1.90%
1987-01-01	3.7	3.66%
1988-01-01	4.1	4.08%
1989-01-01	4.8	4.83%
1990-01-01	5.4	5.40%
1991-01-01	4.2	4.23%
1992-01-01	3.0	3.03%
1993-01-01	3.0	2.95%
1994-01-01	2.6	2.61%
1995-01-01	2.8	2.81%
1996-01-01	2.9	2.93%
1997-01-01	2.3	2.34%
1998-01-01	1.6	1.55%

1999-01-01	2.2	2.19%										
2000-01-01	3.4	3.38%										
2001-01-01	2.8	2.83%										
2002-01-01	1.6	1.59%										
2003-01-01	2.3	2.27%										
2004-01-01	2.7	2.68%										
2005-01-01	3.4	3.39%										
2006-01-01	3.2	3.23%										
2007-01-01	2.9	2.85%										
2008-01-01	3.8	3.84%										
2009-01-01	-0.4	-0.36%										
2010-01-01	1.6	1.64%										
2011-01-01	3.2	3.16%										
2012-01-01	2.1	2.07%										
2013-01-01	1.5	1.46%										
2014-01-01	1.6	1.62%										
2015-01-01	0.1	0.12%										
2016-01-01	1.3	1.26%										
2017-01-01	2.1	2.13%										
2018-01-01	2.4	2.44%										
2019-01-01	#N/A											

Summary for ppt

	Arithmetic Average		*Geometric Average*		
	Stocks - T. Bill	Stocks - T. Bond	Stocks - T. Bill	Stocks - T. Bonds	
1928-2019	8.18%	6.43%	6.35%	4.83%	
Std Error	*2.08%*	*2.20%*			
1970-2019	7.26%	4.50%	5.93%	3.52%	
Std Error	*2.38%*	*2.73%*			
2010-2019	13.51%	9.67%	12.93%	9.31%	
Std Error	*3.85%*	*4.87%*			

Home Price data from Robert Shiller's website.

Date	From fig2.1R	Chg in House Price
1890	3.56	
1891	3.21	-9.79%
1892	3.27	1.81%
1893	3.41	4.26%
1894	3.97	16.52%
1895	3.60	-9.21%
1896	3.12	-12.37%
1897	3.22	3.16%
1898	3.43	6.49%
1899	3.28	-4.40%
1900	3.75	14.34%
1901	3.15	-16.10%
1902	3.71	17.90%
1903	3.77	1.56%
1904	3.94	4.62%
1905	3.45	-12.37%
1906	4.10	18.66%
1907	4.52	10.34%
1908	4.08	-9.76%
1909	3.99	-2.26%
1910	4.31	8.01%
1911	4.21	-2.29%
1912	4.37	3.86%
1913	4.37	0.00%
1914	4.53	3.72%
1915	4.16	-8.19%
1916	4.56	9.48%
1917	4.65	2.04%
1918	4.94	6.37%
1919	5.44	9.98%
1920	5.96	9.61%
1921	5.83	-2.24%
1922	5.91	1.39%
1923	5.99	1.47%
1924	6.01	0.19%
1925	6.32	5.22%
1926	6.06	-4.04%
1927	5.84	-3.73%
1928	5.92	1.49%
1929	5.80	-2.06%
1930	5.55	-4.30%
1931	5.10	-8.15%
1932	4.57	-10.47%
1933	4.39	-3.81%
1934	4.52	2.91%
1935	4.96	9.77%
1936	5.12	3.22%
1937	5.25	2.56%
1938	5.21	-0.67%
1939	5.14	-1.30%
1940	5.31	3.31%
1941	4.86	-8.38%
1942	5.03	3.33%
1943	5.60	11.45%
1944	6.53	16.58%
1945	7.30	11.78%
1946	9.06	24.10%
1947	10.99	21.26%
1948	11.21	2.06%
1949	11.22	0.09%
1950	11.63	3.64%
1951	12.33	6.05%
1952	12.88	4.41%
1953	14.36	11.52%
1954	14.49	0.92%
1955	14.49	0.00%
1956	14.62	0.91%
1957	15.02	2.72%
1958	15.12	0.66%
1959	15.14	0.11%
1960	15.25	0.77%
1961	15.40	0.98%
1962	15.45	0.32%
1963	15.78	2.14%
1964	15.98	1.26%
1965	16.25	1.66%
1966	16.45	1.22%
1967	16.83	2.32%
1968	17.52	4.13%
1969	18.75	6.99%
1970	20.29	8.22%
1971	21.15	4.24%
1972	21.78	2.98%
1973	22.53	3.42%
1974	24.79	10.07%
1975	26.47	6.76%
1976	28.64	8.20%
1977	32.84	14.66%
1978	38.00	15.71%
1979	43.22	13.74%
1980	46.42	7.40%
1981	48.78	5.08%
1982	49.06	0.57%
1983	51.39	4.75%
1984	53.79	4.67%
1985	57.81	7.47%
1986	63.37	9.62%
1987	68.36	7.87%
1988	73.29	7.21%
1989	76.50	4.38%
1990	75.97	-0.69%
1991	75.83	-0.18%
1992	76.47	0.84%

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CSUSHPINS: S&P/Case-Shiller U.S. National Home Price Index, Percent Change from Year Ago of (Index Jan 2000=100), Annual, Not Seasonally Adjusted

Frequency: Annual

observation_d	CSUSHPINSA	
1988-01-01	7.2	7.21%
1989-01-01	4.4	4.38%
1990-01-01	-0.7	-0.70%
1991-01-01	-0.2	-0.18%
1992-01-01	0.8	0.84%
1993-01-01	2.2	2.16%
1994-01-01	2.5	2.52%
1995-01-01	1.8	1.81%
1996-01-01	2.4	2.43%
1997-01-01	4.0	4.03%
1998-01-01	6.4	6.44%
1999-01-01	7.7	7.69%
2000-01-01	9.3	9.25%
2001-01-01	6.7	6.68%
2002-01-01	9.6	9.56%
2003-01-01	9.8	9.82%
2004-01-01	13.6	13.64%
2005-01-01	13.5	13.51%
2006-01-01	1.7	1.73%
2007-01-01	-5.4	-5.40%
2008-01-01	-12.0	-12.00%
2009-01-01	-3.9	-3.85%
2010-01-01	-4.1	-4.12%
2011-01-01	-3.9	-3.90%
2012-01-01	6.5	6.45%
2013-01-01	10.7	10.71%
2014-01-01	4.5	4.52%
2015-01-01	5.2	5.22%
2016-01-01	5.3	5.33%
2017-01-01	6.2	6.23%
2018-01-01	4.5	4.55%
2019-01-01	#N/A	

1993	78.12	2.16%													
1994	80.08	2.51%													
1995	81.53	1.81%													
1996	83.51	2.43%													
1997	86.88	4.04%													
1998	92.47	6.43%													
1999	99.58	7.69%													
2000	108.79	9.25%													
2001	116.06	6.68%													
2002	127.15	9.56%													
2003	139.63	9.82%													
2004	158.68	13.64%													
2005	180.11	13.51%													
2006	183.24	1.74%													
2007	173.35	-5.40%													
2008	152.55	-12.00%													
2009	146.67	-3.85%													
2010	140.64	-4.11%													
2011	135.16	-3.90%													
2012	143.88	6.45%													
2013	159.29	10.71%													
2014	166.49	4.52%													
2015	175.18	5.22%													
2016	184.52	5.33%													
2017	196.01	6.23%													
2018	204.92	4.55%													
2019	211.96	3.44%	*End of October 2019*												

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AAA — Moody's Seasoned Aaa Corporate Bond Yield, Percent, Annual, Not Seasonally Adjusted

Frequency: Annual

observation_date	AAA	% Rate
1919-01-01	5.73	5.73%
1920-01-01	6.26	6.26%
1921-01-01	5.50	5.50%
1922-01-01	5.08	5.08%
1923-01-01	5.09	5.09%
1924-01-01	4.95	4.95%
1925-01-01	4.85	4.85%
1926-01-01	4.68	4.68%
1927-01-01	4.46	4.46%
1928-01-01	4.61	4.61%
1929-01-01	4.67	4.67%
1930-01-01	4.52	4.52%
1931-01-01	5.32	5.32%
1932-01-01	4.59	4.59%
1933-01-01	4.50	4.50%
1934-01-01	3.81	3.81%
1935-01-01	3.44	3.44%
1936-01-01	3.10	3.10%
1937-01-01	3.21	3.21%
1938-01-01	3.08	3.08%
1939-01-01	2.94	2.94%
1940-01-01	2.71	2.71%
1941-01-01	2.80	2.80%
1942-01-01	2.81	2.81%
1943-01-01	2.74	2.74%
1944-01-01	2.70	2.70%
1945-01-01	2.61	2.61%
1946-01-01	2.61	2.61%
1947-01-01	2.86	2.86%
1948-01-01	2.79	2.79%
1949-01-01	2.58	2.58%
1950-01-01	2.67	2.67%
1951-01-01	3.01	3.01%
1952-01-01	2.97	2.97%
1953-01-01	3.13	3.13%
1954-01-01	2.90	2.90%
1955-01-01	3.15	3.15%
1956-01-01	3.75	3.75%
1957-01-01	3.81	3.81%
1958-01-01	4.08	4.08%
1959-01-01	4.58	4.58%
1960-01-01	4.35	4.35%
1961-01-01	4.42	4.42%
1962-01-01	4.24	4.24%
1963-01-01	4.35	4.35%
1964-01-01	4.44	4.44%
1965-01-01	4.68	4.68%
1966-01-01	5.39	5.39%
1967-01-01	6.19	6.19%
1968-01-01	6.45	6.45%
1969-01-01	7.72	7.72%
1970-01-01	7.64	7.64%
1971-01-01	7.25	7.25%
1972-01-01	7.08	7.08%
1973-01-01	7.68	7.68%
1974-01-01	8.89	8.89%
1975-01-01	8.79	8.79%
1976-01-01	7.98	7.98%
1977-01-01	8.19	8.19%
1978-01-01	9.16	9.16%
1979-01-01	10.74	10.74%
1980-01-01	13.21	13.21%
1981-01-01	14.23	14.23%
1982-01-01	11.83	11.83%
1983-01-01	12.57	12.57%
1984-01-01	12.13	12.13%
1985-01-01	10.16	10.16%
1986-01-01	8.49	8.49%
1987-01-01	10.11	10.11%
1988-01-01	9.57	9.57%
1989-01-01	8.86	8.86%
1990-01-01	9.05	9.05%
1991-01-01	8.31	8.31%
1992-01-01	7.98	7.98%
1993-01-01	6.93	6.93%
1994-01-01	8.46	8.46%
1995-01-01	6.82	6.82%
1996-01-01	7.20	7.20%
1997-01-01	6.76	6.76%
1998-01-01	6.22	6.22%
1999-01-01	7.55	7.55%
2000-01-01	7.21	7.21%
2001-01-01	6.77	6.77%
2002-01-01	6.21	6.21%
2003-01-01	5.62	5.62%
2004-01-01	5.47	5.47%
2005-01-01	5.37	5.37%
2006-01-01	5.32	5.32%
2007-01-01	5.49	5.49%
2008-01-01	5.05	5.05%
2009-01-01	5.26	5.26%
2010-01-01	5.02	5.02%
2011-01-01	3.93	3.93%
2012-01-01	3.65	3.65%
2013-01-01	4.62	4.62%
2014-01-01	3.79	3.79%
2015-01-01	3.97	3.97%
2016-01-01	4.06	4.06%
2017-01-01	3.51	3.51%
2018-01-01	4.02	4.02%
2019-01-01	3.01	3.01%

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BAA — Moody's Seasoned Baa Corporate Bond Yield, Percent, Annual, Not Seasonally Adjusted

Frequency: Annual

observation_date	BAA	
1919-01-01	7.77	7.77%
1920-01-01	8.56	8.56%
1921-01-01	7.61	7.61%
1922-01-01	7.02	7.02%
1923-01-01	7.38	7.38%
1924-01-01	6.46	6.46%
1925-01-01	6.15	6.15%
1926-01-01	5.68	5.68%
1927-01-01	5.32	5.32%
1928-01-01	5.60	5.60%
1929-01-01	5.95	5.95%
1930-01-01	6.71	6.71%
1931-01-01	10.42	10.42%
1932-01-01	8.42	8.42%
1933-01-01	7.75	7.75%
1934-01-01	6.23	6.23%
1935-01-01	5.30	5.30%
1936-01-01	4.53	4.53%
1937-01-01	5.73	5.73%
1938-01-01	5.27	5.27%
1939-01-01	4.92	4.92%
1940-01-01	4.45	4.45%
1941-01-01	4.38	4.38%
1942-01-01	4.28	4.28%
1943-01-01	3.82	3.82%
1944-01-01	3.49	3.49%
1945-01-01	3.10	3.10%
1946-01-01	3.17	3.17%
1947-01-01	3.52	3.52%
1948-01-01	3.53	3.53%
1949-01-01	3.31	3.31%
1950-01-01	3.20	3.20%
1951-01-01	3.61	3.61%
1952-01-01	3.51	3.51%
1953-01-01	3.74	3.74%
1954-01-01	3.45	3.45%
1955-01-01	3.62	3.62%
1956-01-01	4.37	4.37%
1957-01-01	5.03	5.03%
1958-01-01	4.85	4.85%
1959-01-01	5.28	5.28%
1960-01-01	5.10	5.10%
1961-01-01	5.10	5.10%
1962-01-01	4.92	4.92%
1963-01-01	4.85	4.85%
1964-01-01	4.81	4.81%
1965-01-01	5.02	5.02%
1966-01-01	6.18	6.18%
1967-01-01	6.93	6.93%
1968-01-01	7.23	7.23%
1969-01-01	8.65	8.65%
1970-01-01	9.12	9.12%
1971-01-01	8.38	8.38%
1972-01-01	7.93	7.93%
1973-01-01	8.48	8.48%
1974-01-01	10.63	10.63%
1975-01-01	10.56	10.56%
1976-01-01	9.12	9.12%
1977-01-01	8.99	8.99%
1978-01-01	9.94	9.94%
1979-01-01	12.06	12.06%
1980-01-01	15.14	15.14%
1981-01-01	16.55	16.55%
1982-01-01	14.14	14.14%
1983-01-01	13.75	13.75%
1984-01-01	13.40	13.40%
1985-01-01	11.58	11.58%
1986-01-01	9.97	9.97%
1987-01-01	11.29	11.29%
1988-01-01	10.65	10.65%
1989-01-01	9.82	9.82%
1990-01-01	10.43	10.43%
1991-01-01	9.26	9.26%
1992-01-01	8.81	8.81%
1993-01-01	7.69	7.69%
1994-01-01	9.10	9.10%
1995-01-01	7.49	7.49%
1996-01-01	7.89	7.89%
1997-01-01	7.32	7.32%
1998-01-01	7.23	7.23%
1999-01-01	8.19	8.19%
2000-01-01	8.02	8.02%
2001-01-01	8.05	8.05%
2002-01-01	7.45	7.45%
2003-01-01	6.60	6.60%
2004-01-01	6.15	6.15%
2005-01-01	6.32	6.32%
2006-01-01	6.22	6.22%
2007-01-01	6.65	6.65%
2008-01-01	8.43	8.43%
2009-01-01	6.37	6.37%
2010-01-01	6.10	6.10%
2011-01-01	5.25	5.25%
2012-01-01	4.63	4.63%
2013-01-01	5.38	5.38%
2014-01-01	4.74	4.74%
2015-01-01	5.46	5.46%
2016-01-01	4.83	4.83%
2017-01-01	4.22	4.22%
2018-01-01	5.13	5.13%
2019-01-01	3.88	3.88%

ATMOS ENERGY CORP. NYSE-ATO

RECENT PRICE 104.12 | P/E RATIO 21.4 (Trailing: 22.2, Median: 18.0) | RELATIVE P/E RATIO 0.97 | DIV'D YLD 2.4% | VALUE LINE

TIMELINESS 2 Raised 8/28/20
SAFETY 1 Raised 6/6/14
TECHNICAL 4 Lowered 8/28/20
BETA .80 (1.00 = Market)

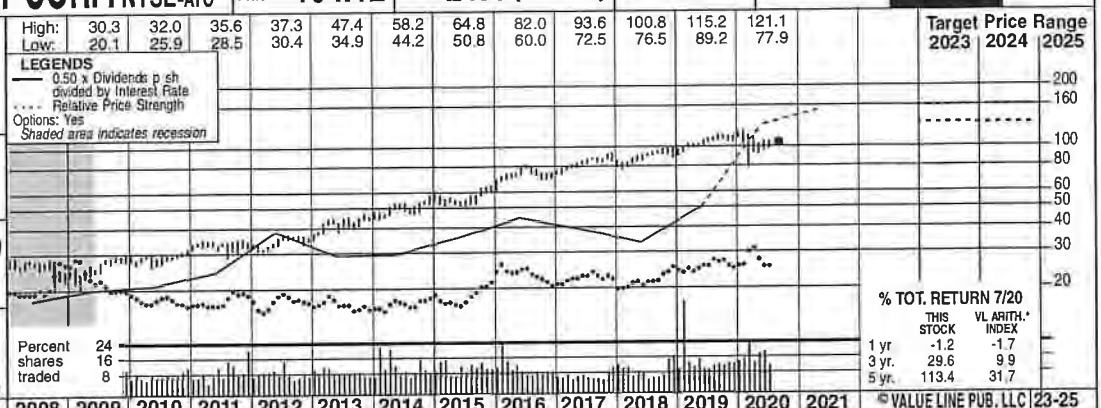
18-Month Target Price Range
Low-High Midpoint (% to Mid)
$81-$180 $131 (25%)

2023-25 PROJECTIONS

	Price	Gain	Ann'l Total Return
High	160	(+55%)	13%
Low	130	(+25%)	8%

Institutional Decisions

	3Q2019	4Q2019	1Q2020
to Buy	262	272	268
to Sell	193	215	251
Hld's(000)	99815	102747	103070



2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	© VALUE LINE PUB. LLC	23-25
46.50	61.75	75.27	66.03	79.52	53.69	53.12	48.15	38.10	42.88	49.22	40.82	32.23	26.01	28.00	24.32	*22.60*	*22.70*	Revenues per sh A	*37.95*
2.91	3.90	4.26	4.14	4.19	4.29	4.64	4.72	4.76	5.14	5.42	5.81	6.19	6.62	7.24	7.57	*8.15*	*8.45*	"Cash Flow" per sh	*9.80*
1.58	1.72	2.00	1.94	2.00	1.97	2.16	2.26	2.10	2.50	2.96	3.09	3.38	3.60	4.00	4.35	*4.70*	*4.95*	Earnings per sh AB	*6.00*
1.22	1.24	1.26	1.28	1.30	1.32	1.34	1.36	1.38	1.40	1.48	1.56	1.68	1.80	1.94	2.10	*2.30*	*2.46*	Div'ds Decl'd per sh C■	*3.00*
3.03	4.14	5.20	4.39	5.20	5.51	6.02	6.90	8.12	9.32	8.32	9.61	10.46	10.72	13.19	14.19	*15.30*	*15.40*	Cap'l Spending per sh	*15.50*
18.05	19.90	20.16	22.01	22.60	23.52	24.16	24.98	26.14	28.47	30.74	31.48	33.32	36.74	42.87	48.18	*53.75*	*57.25*	Book Value per sh	*66.20*
62.80	80.54	81.74	89.33	90.81	92.55	90.16	90.30	90.24	90.64	100.39	101.48	103.93	106.10	111.27	119.34	*124.00*	*130.00*	Common Shs Outst'g D	*145.00*
15.9	16.1	13.5	15.9	13.6	12.5	13.2	14.4	15.9	15.9	16.1	17.5	20.8	22.0	21.7	23.2	*Bold figures are*		Avg Ann'l P/E Ratio	*24.0*
.84	.86	.73	.84	.82	.83	.84	.90	1.01	.89	.85	.88	1.09	1.11	1.17	1.27	*Value Line*		Relative P/E Ratio	*1.35*
4.9%	4.5%	4.7%	4.2%	4.8%	5.3%	4.7%	4.2%	4.1%	3.5%	3.1%	2.9%	2.4%	2.3%	2.2%	2.1%	*estimates*		Avg Ann'l Div'd Yield	*2.1%*
4789.7	4347.6	3438.5	3886.3	4940.9	4142.1	3349.9	2759.7	3115.5	2901.8	*2800*	*2950*	Revenues ($mill) A	*5500*
201.2	199.3	192.2	230.7	289.8	315.1	350.1	382.7	444.3	511.4	*585*	*645*	Net Profit ($mill)	*870*
38.5%	36.4%	33.8%	38.2%	39.2%	38.3%	36.4%	36.6%	27.0%	21.4%	*19.5%*	*20.5%*	Income Tax Rate	*24.0%*
4.2%	4.6%	5.6%	5.9%	5.9%	7.6%	10.5%	13.9%	14.3%	17.6%	*20.9%*	*21.9%*	Net Profit Margin	*15.8%*
45.4%	49.4%	45.3%	48.8%	44.3%	43.5%	38.7%	44.0%	34.3%	38.0%	*41.0%*	*40.0%*	Long-Term Debt Ratio	*40.0%*
54.6%	50.6%	54.7%	51.2%	55.7%	56.5%	61.3%	56.0%	65.7%	62.0%	*59.0%*	*60.0%*	Common Equity Ratio	*60.0%*
3987.9	4461.5	4315.5	5036.1	5542.2	5650.2	5651.8	6965.7	7263.6	9279.7	*11300*	*12400*	Total Capital ($mill)	*16000*
4793.1	5147.9	5475.6	6030.7	6725.9	7430.6	8280.5	9259.2	10371	11788	*13100*	*14300*	Net Plant ($mill)	*18000*
6.9%	6.1%	6.1%	5.9%	6.4%	6.6%	7.2%	6.4%	6.9%	6.1%	*6.5%*	*6.5%*	Return on Total Cap'l	*6.5%*
9.2%	8.8%	8.1%	8.9%	9.4%	9.9%	10.1%	9.8%	9.3%	8.9%	*9.0%*	*8.5%*	Return on Shr. Equity	*9.0%*
9.2%	8.8%	8.1%	8.9%	9.4%	9.9%	10.1%	9.8%	9.3%	8.9%	*9.0%*	*8.5%*	Return on Com Equity	*9.0%*
3.5%	3.3%	2.8%	4.0%	4.7%	4.9%	5.1%	4.9%	4.8%	4.6%	*4.5%*	*4.5%*	Retained to Com Eq	*4.5%*
62%	62%	65%	56%	50%	51%	50%	50%	48%	48%	*49%*	*50%*	All Div'ds to Net Prof	*50%*

CAPITAL STRUCTURE as of 6/30/20
Total Debt $4531.5 mill. **Due in 5 Yrs** $565.0 mill.
LT Debt $4531.3 mill. **LT Interest** $275.0 mill.
(LT interest earned: 7.3x; total interest coverage: 7.3x)
Leases, Uncapitalized Annual rentals $21.0 mill.

Pfd Stock None

Pension Assets-9/19 $530.1 mill.
Oblig. $577.3 mill.
Common Stock 123,354,982 shs.
as of 7/31/20

MARKET CAP: $12.8 billion (Large Cap)

CURRENT POSITION ($MILL.)	2018	2019	6/30/20
Cash Assets	13.8	24.5	208.1
Other	465.1	433.5	394.1
Current Assets	478.9	458.0	602.2
Accts Payable	217.3	265.0	200.1
Debt Due	1150.8	464.9	.2
Other	547.0	479.5	502.4
Current Liab.	1915.1	1209.4	702.7
Fix. Chg. Cov.	926%	990%	980%

ANNUAL RATES of change (per sh)	Past 10 Yrs.	Past 5 Yrs.	Est'd '17-'19 to '23-'25
Revenues	-9.0%	-9.5%	*6.5%*
"Cash Flow"	5.5%	7.0%	*5.5%*
Earnings	7.5%	9.5%	*7.0%*
Dividends	4.0%	6.5%	*7.5%*
Book Value	6.5%	8.5%	*7.5%*

Fiscal Year Ends	QUARTERLY REVENUES ($ mill.) A Dec.31	Mar.31	Jun.30	Sep.30	Full Fiscal Year
2017	780.2	988.2	526.5	464.8	2759.7
2018	889.2	1219.4	562.2	444.7	3115.5
2019	877.8	1094.6	485.7	443.7	2901.8
2020	875.6	977.6	493.0	*453.8*	*2800*
2021	*890*	*1050*	*540*	*470*	*2950*

Fiscal Year Ends	EARNINGS PER SHARE A B E Dec.31	Mar.31	Jun.30	Sep.30	Full Fiscal Year
2017	1.08	1.52	.67	.34	3.60
2018	1.40	1.57	.64	.41	4.00
2019	1.38	1.82	.68	.49	4.35
2020	1.47	1.95	.79	*.49*	*4.70*
2021	*1.53*	*2.05*	*.81*	*.56*	*4.95*

Cal-endar	QUARTERLY DIVIDENDS PAID C■ Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2016	.42	.42	.42	.45	1.71
2017	.45	.45	.45	.485	1.84
2018	.485	.485	.485	.525	1.98
2019	.525	.525	.525	.575	2.15
2020	.575	.575	.575		

BUSINESS: Atmos Energy Corporation is engaged primarily in the distribution and sale of natural gas to over three million customers through six regulated natural gas utility operations: Louisiana Division, West Texas Division, Mid-Tex Division, Mississippi Division, Colorado-Kansas Division, and Kentucky/Mid-States Division. Gas sales breakdown for fiscal 2019: 66%, residential; 27%, commercial; 5%, industrial; and 2% other. The company sold Atmos Energy Marketing, 1/17. Officers and directors own approximately 1.4% of common stock (12/19 Proxy). President and Chief Executive Officer: Kevin Akers. Incorporated: Texas. Address: Three Lincoln Centre, Suite 1800, 5430 LBJ Freeway, Dallas, Texas 75240. Telephone: 972-934-9227. Internet: www.atmosenergy.com.

Atmos Energy Corporation, though not immune to the effects of COVID-19, has performed fairly well of late. In fact, during the first nine months of fiscal 2020 (which ends September 30th), share net advanced 8.5%, to $4.21, versus the $3.88 tally for the same period last year. That was brought about partially by the natural gas distribution business, which got a lift from higher rates, mostly in the Mississippi, Mid-Tex, Louisiana, and West Texas divisions. Customer growth, mainly in the Mid-Tex operation, also helped. Elsewhere, results of the pipeline and storage division enjoyed an increase in revenue from Gas Reliability Infrastructure Program filings approved in fiscal 2019 and 2020. If there are no major setbacks in the fourth quarter, it seems that profits will climb around 8%, to $4.70 a share, for the entire fiscal year. Looking at fiscal 2021, the company's share net might rise another 5%, to $4.95, as operating margins widen further.

Finances remain in strong shape. At the conclusion of June, cash and equivalents amounted to $208.1 million. Moreover, long-term debt was a manageable 41% of total capital, and short-term obligations were minimal. Also, approximately $3 billion of common stock and/or debt securities remained available for issuance (out of $4 billion) under a shelf registration statement that expires in February, 2023. Finally, the company can access four revolving credit facilities aggregating $2.2 billion plus a $1.5 billion commercial paper program. All things considered, Atmos Energy ought to have little difficulty satisfying its commitments (including working capital needs and dividend payments) for some time. Acquisitions are also possible.

The high-quality stock has strengthened a bit in price over the past few months. We believe that movement can be traced, to a certain degree, to the company's solid earnings in fiscal 2020. Too, these shares are pegged at 2 (Above Average) for Timeliness. What's more, capital appreciation potential during the 18-month period looks solid. But the dividend yield does not stand out compared to the average of *Value Line's* Natural Gas Utility Industry group.

Frederick L. Harris, III *August 28, 2020*

(A) Fiscal year ends Sept. 30th. (B) Diluted shrs. Excl. nonrec. gains (loss): '10, 5¢; '11, (1¢); '18, $1.43; 3Q '20, 17¢. Excludes discontinued operations: '11, 10¢; '12, 27¢; '13, 14¢; '17, 13¢. Next egs. rpt. due early Nov. (C) Dividends historically paid in early March, June, Sept., and Dec. ■ Div. reinvestment plan. Direct stock purchase plan avail. (D) In millions. (E) Qtrs may not add due to change in shrs outstanding.

Company's Financial Strength	A+
Stock's Price Stability	95
Price Growth Persistence	85
Earnings Predictability	100

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NEW JERSEY RES. NYSE-NJR

RECENT PRICE	P/E RATIO	RELATIVE P/E RATIO	DIV'D YLD	VALUE LINE
32.48	15.2 (Trailing: 18.1 Median: 17.0)	0.69	3.8%	

TIMELINESS 4 Lowered 4/3/20
SAFETY 2 Lowered 4/17/20
TECHNICAL 3 Raised 6/19/20
BETA .90 (1.00 = Market)

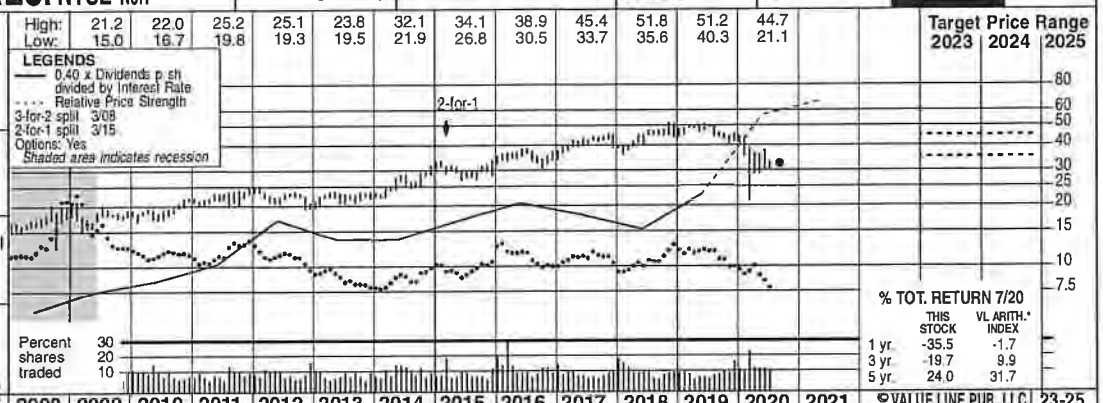
18-Month Target Price Range
Low-High Midpoint (% to Mid)
$25-$57 $41 (25%)

2023-25 PROJECTIONS

	Price	Gain	Ann'l Total Return
High	45	(+40%)	12%
Low	35	(+10%)	6%

Institutional Decisions

	3Q2019	4Q2019	1Q2020
to Buy	125	169	123
to Sell	102	99	131
Hld's(000)	61471	67787	67063



Target Price Range 2023 | 2024 | 2025
80 60 50 40 30 25 20 15 10 7.5

% TOT. RETURN 7/20

	THIS STOCK	VL ARITH.* INDEX
1 yr.	-35.5	-1.7
3 yr.	-19.7	9.9
5 yr.	24.0	31.7

2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	©VALUE LINE PUB. LLC	23-25
30.44	38.10	39.81	36.31	45.37	31.17	32.05	36.30	27.08	38.38	44.40	32.09	21.90	26.28	33.24	29.01	*21.35*	*28.35*	Revenues per sh A	*30.05*
1.25	1.31	1.37	1.22	1.81	1.58	1.63	1.70	1.86	1.93	2.73	2.52	2.46	2.68	3.72	2.99	*2.90*	*3.30*	"Cash Flow" per sh	*3.55*
.85	.88	.93	.78	1.35	1.20	1.23	1.29	1.36	1.37	2.08	1.78	1.61	1.73	2.72	1.96	*1.90*	*2.25*	Earnings per sh B	*2.40*
.43	.45	.48	.51	.56	.62	.68	.72	.77	.81	.86	.93	.98	1.04	1.11	1.19	*1.27*	*1.34*	Div'ds Decl'd per sh C■	*1.57*
.72	.64	.64	.73	.86	.90	1.05	1.13	1.26	1.33	1.52	3.76	4.15	3.80	4.39	5.83	*4.70*	*4.10*	Cap'l Spending per sh	*4.00*
5.62	5.30	7.50	7.75	8.64	8.29	8.81	9.36	9.80	10.65	11.48	12.99	13.58	14.33	16.18	17.37	*20.50*	*21.65*	Book Value per sh D	*25.80*
83.22	82.64	82.88	83.22	84.12	83.17	82.35	82.89	83.05	83.32	84.20	85.19	85.86	86.32	87.69	89.34	*96.00*	*97.00*	Common Shs Outst'g E	*100.00*
15.3	16.8	16.1	21.6	12.3	14.9	15.0	16.8	16.8	16.0	11.7	16.6	21.3	22.4	15.6	24.3	*Bold figures are*		Avg Ann'l P/E Ratio	*17.0*
.81	.89	.87	1.15	.74	.99	.95	1.05	1.07	.90	.62	.84	1.12	1.13	.84	1.33	*Value Line*		Relative P/E Ratio	*.95*
3.3%	3.1%	3.2%	3.0%	3.3%	3.5%	3.7%	3.3%	3.4%	3.7%	3.5%	3.1%	2.9%	2.7%	2.6%	2.5%	*estimates*		Avg Ann'l Div'd Yield	*3.7%*
2639.3	3009.2	2248.9	3198.1	3738.1	2734.0	1880.9	2268.6	2915.1	2592.0	*2050*	*2750*	Revenues ($mill) A	*3005*
101.8	106.5	112.4	113.7	176.9	153.7	138.1	149.4	240.5	175.0	*185*	*220*	Net Profit ($mill)	*240*
41.4%	30.2%	7.1%	25.4%	30.2%	26.3%	15.5%	17.2%	NMF	NMF	*15.0%*	*15.0%*	Income Tax Rate	*15.0%*
3.9%	3.5%	5.0%	3.6%	4.7%	5.6%	7.3%	6.6%	8.2%	6.7%	*8.9%*	*8.0%*	Net Profit Margin	*8.0%*
37.2%	35.5%	39.2%	36.6%	38.2%	43.2%	47.7%	44.6%	45.4%	49.8%	*44.5%*	*44.5%*	Long-Term Debt Ratio	*43.5%*
62.8%	64.5%	60.8%	63.4%	61.8%	56.8%	52.3%	55.4%	54.6%	50.2%	*55.5%*	*55.5%*	Common Equity Ratio	*56.5%*
1154.4	1203.1	1339.0	1400.3	1564.4	1950.6	2230.1	2233.7	2599.6	3088.9	*3500*	*3800*	Total Capital ($mill)	*4580*
1135.7	1295.9	1484.9	1643.1	1884.1	2128.3	2407.7	2609.7	2651.0	3041.2	*3800*	*3875*	Net Plant ($mill)	*4115*
9.7%	9.7%	9.2%	9.0%	12.1%	8.6%	6.9%	7.7%	10.1%	6.4%	*6.0%*	*6.5%*	Return on Total Cap'l	*6.0%*
14.0%	13.7%	13.8%	12.8%	18.3%	13.9%	11.8%	12.1%	16.9%	11.3%	*9.5%*	*10.5%*	Return on Shr. Equity	*9.5%*
14.0%	13.7%	13.8%	12.8%	18.3%	13.9%	11.8%	12.1%	16.9%	11.3%	*9.5%*	*10.5%*	Return on Com Equity	*9.5%*
6.7%	6.2%	6.2%	5.2%	11.0%	7.0%	4.8%	5.0%	10.2%	4.6%	*3.0%*	*4.5%*	Retained to Com Eq	*3.0%*
52%	55%	55%	59%	40%	50%	60%	59%	40%	59%	*67%*	*59%*	All Div'ds to Net Prof	*65%*

CAPITAL STRUCTURE as of 6/30/20
Total Debt $2243.6 mill. **Due in 5 Yrs** $420.5 mill.
LT Debt $1664.5 mill. **LT Interest** $47.1 mill.
Incl. $38.6 mill. capitalized leases.
(LT interest earned: 5.0x; total interest coverage: 5.0x)
Pension Assets-9/19 $372.6 mill.
Oblig. $620.5 mill.
Pfd Stock None

Common Stock 95,930,191 shs.
as of 8/5/20
MARKET CAP: $3.1 billion (Mid Cap)

CURRENT POSITION ($MILL.)	2018	2019	6/30/20
Cash Assets	1.5	2.7	42.8
Other	768.6	508.9	478.3
Current Assets	770.1	511.6	521.1
Accts Payable	373.5	295.9	222.4
Debt Due	275.5	46.9	579.1
Other	101.9	103.6	100.8
Current Liab.	750.9	446.4	902.3
Fix. Chg. Cov.	545%	545%	550%

ANNUAL RATES of change (per sh)	Past 10 Yrs.	Past 5 Yrs.	Est'd '17-'19 to '23-'25
Revenues	-2.5%	-4.0%	*.5%*
"Cash Flow"	7.5%	7.5%	*2.0%*
Earnings	7.0%	6.0%	*2.0%*
Dividends	7.0%	6.5%	*6.0%*
Book Value	7.0%	8.5%	*8.5%*

Fiscal Year Ends	QUARTERLY REVENUES ($ mill.) A Dec.31	Mar.31	Jun.30	Sep.30	Full Fiscal Year
2017	541.1	733.5	457.5	536.5	2268.6
2018	705.3	1019.0	543.4	647.3	2915.1
2019	811.8	866.3	434.9	479.1	2592.0
2020	615.0	639.6	299.0	*496.4*	*2050*
2021	*665*	*965*	*535*	*585*	*2750*

Fiscal Year Ends	EARNINGS PER SHARE A B Dec.31	Mar.31	Jun.30	Sep.30	Full Fiscal Year
2017	.47	1.21	.20	d.14	1.73
2018	1.53	1.61	d.09	d.33	2.72
2019	.61	1.27	d.20	.29	1.96
2020	.44	1.12	d.06	*.40*	*1.90*
2021	*.55*	*1.25*	*d.05*	*.50*	*2.25*

Calendar	QUARTERLY DIVIDENDS PAID C ■ Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2016	.24	.24	.24	.255	.98
2017	.255	.255	.255	.273	1.04
2018	.273	.273	.273	.2925	1.11
2019	.2925	.2925	.2925	.3125	1.19
2020	.3125	.3125	.3125		

BUSINESS: New Jersey Resources Corp. is a holding company providing retail/wholesale energy svcs. to customers in NJ, and in states from the Gulf Coast to New England, and Canada. New Jersey Natural Gas had 547,600 cust. at 9/30/19. Fiscal 2019 volume: 232 bill. cu. ft. (17% interruptible, 17% res., 9% commercial & elec. utility, 40% capacity release programs). N.J. Natural Energy subsidiary provides unregulated retail/wholesale natural gas and related energy svcs. 2019 dep. rate: 2.6%. Has 1,108 empls. Off./dir. own 1.3% of common; BlackRock, 13.9%; Vanguard, 10.4% (12/19 Proxy). CEO, President & Director: Steven D. Westhoven. Incorporated: New Jersey. Address: 1415 Wyckoff Road, Wall, NJ 07719. Telephone: 732-938-1480. Web: www.njresources.com.

New Jersey Resources posted mixed results for its fiscal third quarter (ended June 30th). To wit, the top line fell 31.2% on a year-over-year basis, to $299.0 million. This reflected a hefty, almost 85% drop in nonutility volumes, partially offset by a 6.4% rise in its utility business. Meanwhile, on the profitability front, total expenses increased 590 basis points as a percentage of revenues. All told, after excluding unrealized losses on derivative instruments and hedging activities, and accounting for a healthy uptick in the number of common shares outstanding, NJR's bottom line loss improved nearly 70%, to a deficit of $0.06 a share. This bested our call for a loss of $0.14.

We have raised our earnings outlook for fiscal 2020 (ends September 30th). The volume slump a the nonutility business will likely drag down NJR's overall top line. In fact, we think the retail and wholesale energy services provider will experience a roughly 20% drop in revenues this year, to $2.050 billion. This will largely reflect weakness at the Energy Services segment. Alternatively, the New Jersey Natural Gas (NJNG) regulated utility business appears poised to perform quite well this year. To that end, NJNG has added 5,879 new customer accounts over the first nine months of this fiscal year. What's more, management plans to add 28,000-30,000 new meters in the 2020-2022 time frame. In light of the recent stronger-than-anticipated earnings, we have added $0.40 to our bottom-line call, bringing that estimate to $1.90. Still, the challenging operating environment is weighing on New Jersey Resources' business mix. This is evident in our estimated annual earnings decline of about 3%.

The overall financial position is in good shape. So far this year, cash reserves swelled nearly 15-fold, to $42.8 million. At the same time, the long-term debt load ticked about 8.5% higher, and now represents a relatively normal 48% of total capital when viewed against other companies in this space.

At the recent quotation, shares of New Jersey Resources do not stand out. The stock market appears to have already priced in the earnings growth we envision for the pull to 2023-2025.

Bryan J. Fong *August 28, 2020*

(A) Fiscal year ends Sept. 30th.
(B) Diluted earnings. Qtly. sales and egs. may not sum to total due to rounding and change in shares outstanding. Next earnings report due early Nov.
(C) Dividends historically paid in early Jan., April, July, and October. ■ Dividend reinvestment plan available.
(D) Includes regulatory assets in 2019: $496.6 million, $5.56/share.
(E) In millions, adjusted for splits.

Company's Financial Strength	A+
Stock's Price Stability	85
Price Growth Persistence	70
Earnings Predictability	45

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N.W. NATURAL NYSE-NWN

RECENT PRICE 53.22 | P/E RATIO 22.5 (Trailing: 25.8 / Median: 23.0) | RELATIVE P/E RATIO 1.02 | DIV'D YLD 3.6% | VALUE LINE

TIMELINESS 3 Lowered 5/22/20
SAFETY 1 Raised 3/18/05
TECHNICAL 3 Raised 4/3/20
BETA .80 (1.00 = Market)

18-Month Target Price Range

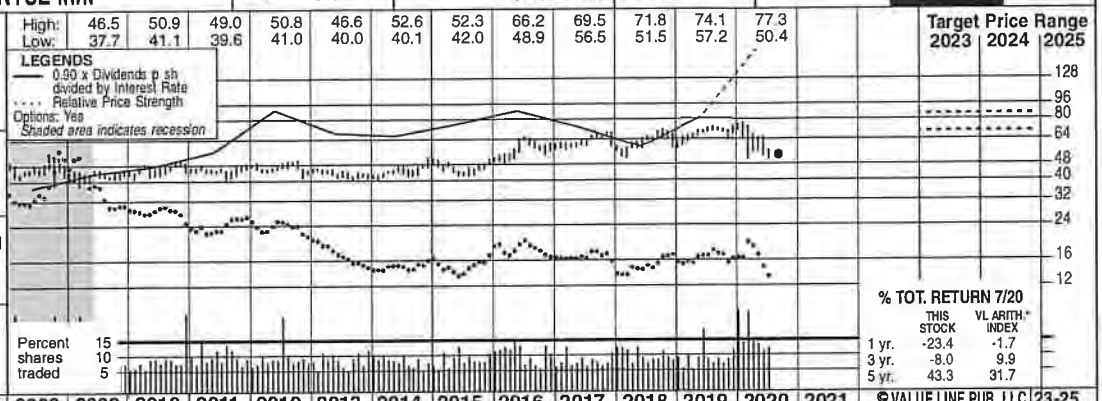
Low-High	Midpoint (% to Mid)
$42-$102	$72 (35%)

2023-25 PROJECTIONS

	Price	Gain	Ann'l Total Return
High	85	(+60%)	15%
Low	70	(+30%)	10%

Institutional Decisions

	3Q2019	4Q2019	1Q2020
to Buy	107	120	88
to Sell	90	95	133
Hld's(000)	21608	23102	22679



	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
High:	46.5	50.9	49.0	50.8	46.6	52.6	52.3	66.2	69.5	71.8	74.1	77.3						
Low:	37.7	41.1	39.6	41.0	40.0	40.1	42.0	48.9	56.5	51.5	57.2	50.4						
Revenues per sh	25.69	33.01	37.20	39.13	39.16	38.17	30.56	31.72	27.14	28.02	27.64	26.39	23.61	26.52	24.45	24.49	*25.15*	*26.45*
"Cash Flow" per sh	3.92	4.34	4.76	5.41	5.31	5.20	5.18	5.00	4.94	5.04	5.05	4.91	4.93	1.04	5.28	5.15	*4.85*	*5.20*
Earnings per sh A	1.86	2.11	2.35	2.76	2.57	2.83	2.73	2.39	2.22	2.24	2.16	1.96	2.12	d1.94	2.33	2.19	*2.35*	*2.55*
Div'ds Decl'd per sh B■	1.30	1.32	1.39	1.44	1.52	1.60	1.68	1.75	1.79	1.83	1.85	1.86	1.87	1.88	1.89	1.90	*1.91*	*1.92*
Cap'l Spending per sh	5.52	3.48	3.55	4.48	3.92	5.09	9.35	3.76	4.91	5.13	4.40	4.37	4.87	7.43	7.43	7.95	*7.80*	*6.15*
Book Value per sh D	20.64	21.28	22.01	22.52	23.71	24.88	26.08	26.70	27.23	27.77	28.12	28.47	29.71	25.85	26.41	28.42	*29.70*	*31.85*
Common Shs Outst'g C	27.55	27.58	27.24	26.41	26.50	26.53	26.58	26.76	26.92	27.08	27.28	27.43	28.63	28.74	28.88	30.47	*31.00*	*31.00*
Avg Ann'l P/E Ratio	16.7	17.0	15.9	16.7	18.1	15.2	17.0	19.0	21.1	19.4	20.7	23.7	26.9	--	26.6	30.9	*Bold figures are Value Line estimates*	
Relative P/E Ratio	.88	.91	.86	.89	1.09	1.01	1.08	1.19	1.34	1.09	1.09	1.19	1.41	--	1.44	1.68		
Avg Ann'l Div'd Yield	4.2%	3.7%	3.7%	3.1%	3.3%	3.7%	3.6%	3.9%	3.8%	4.2%	4.1%	4.0%	3.3%	3.0%	3.0%	2.8%		
Revenues ($mill)	812.1	848.8	730.6	758.5	754.0	723.8	676.0	762.2	706.1	746.4	*780*	*820*						
Net Profit ($mill)	72.7	63.9	59.9	60.5	58.7	53.7	58.9	d55.6	67.3	65.3	*80.0*	*85.0*						
Income Tax Rate	40.5%	40.4%	42.4%	40.8%	41.5%	40.0%	40.9%	--	26.4%	16.2%	*21.0%*	*21.0%*						
Net Profit Margin	8.9%	7.5%	8.2%	8.0%	7.8%	7.4%	8.7%	NMF	9.5%	8.8%	*9.4%*	*9.7%*						
Long-Term Debt Ratio	46.1%	47.3%	48.5%	47.6%	44.8%	42.5%	44.4%	47.9%	48.1%	48.2%	*47.5%*	*47.0%*						
Common Equity Ratio	53.9%	52.7%	51.5%	52.4%	55.2%	57.5%	55.6%	52.1%	51.9%	51.8%	*52.5%*	*53.0%*						
Total Capital ($mill)	1284.8	1356.2	1424.7	1433.6	1389.0	1357.7	1529.8	1426.0	1468.9	1672.0	*1755*	*1855*						
Net Plant ($mill)	1854.2	1893.9	1973.6	2062.9	2121.6	2182.7	2260.9	2255.0	2421.4	2438.9	*2535*	*2640*						
Return on Total Cap'l	7.0%	6.2%	5.7%	5.8%	5.8%	5.5%	5.1%	NMF	5.8%	5.2%	*5.0%*	*5.5%*						
Return on Shr. Equity	10.5%	8.9%	8.2%	8.1%	7.6%	6.9%	6.9%	NMF	8.8%	7.5%	*8.0%*	*8.0%*						
Return on Com Equity	10.5%	8.9%	8.2%	8.1%	7.6%	6.9%	6.9%	NMF	8.8%	7.5%	*8.0%*	*8.0%*						
Retained to Com Eq	4.0%	2.4%	1.6%	1.5%	1.1%	.6%	.9%	NMF	2.1%	1.4%	*1.5%*	*2.0%*						
All Div'ds to Net Prof	61%	73%	80%	81%	85%	92%	87%	NMF	76%	82%	*81%*	*75%*						

% TOT. RETURN 7/20

	THIS STOCK	VL ARITH.* INDEX
1 yr.	-23.4	-1.7
3 yr.	-8.0	9.9
5 yr.	43.3	31.7

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	23-25
Revenues per sh	*29.40*
"Cash Flow" per sh	*6.15*
Earnings per sh A	*3.20*
Div'ds Decl'd per sh B■	*1.97*
Cap'l Spending per sh	*6.25*
Book Value per sh D	*38.40*
Common Shs Outst'g C	*32.00*
Avg Ann'l P/E Ratio	*24.0*
Relative P/E Ratio	*1.35*
Avg Ann'l Div'd Yield	*2.6%*
Revenues ($mill)	*940*
Net Profit ($mill)	*95.0*
Income Tax Rate	*21.0%*
Net Profit Margin	*10.9%*
Long-Term Debt Ratio	*47.5%*
Common Equity Ratio	*52.5%*
Total Capital ($mill)	*1825*
Net Plant ($mill)	*3065*
Return on Total Cap'l	*5.5%*
Return on Shr. Equity	*8.5%*
Return on Com Equity	*8.5%*
Retained to Com Eq	*3.0%*
All Div'ds to Net Prof	*61%*

CAPITAL STRUCTURE as of 6/30/20
Total Debt $1187.1 mill. Due in 5 Yrs $910.0 mill.
LT Debt $918.9 mill. LT Interest $40.0 mill.

(Total interest coverage: 3.7x)

Pension Assets-12/19 $313.1 mill.
Oblig. $515.7 mill.

Pfd Stock None

Common Stock 30,547,293 shares
as of 8/3/20

MARKET CAP $1.6 billion (Mid Cap)

CURRENT POSITION ($MILL.)	2018	2019	6/30/20
Cash Assets	12.6	9.6	137.1
Other	283.3	284.1	179.3
Current Assets	295.9	293.7	316.4
Accts Payable	115.9	113.4	79.9
Debt Due	247.6	224.2	268.2
Other	145.6	144.6	138.8
Current Liab.	509.1	482.2	486.9
Fix. Chg. Cov.	357%	336%	368%

ANNUAL RATES of change (per sh)	Past 10 Yrs.	Past 5 Yrs.	Est'd '17-'19 to '23-'25
Revenues	-4.0%	-2.0%	*2.5%*
"Cash Flow"	-3.0%	-5.5%	*8.0%*
Earnings	-11.0%	-17.0%	*24.5%*
Dividends	2.0%	.5%	*1.0%*
Book Value	1.5%	-.5%	*2.0%*

Calendar	QUARTERLY REVENUES ($ mill.) Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2017	297.3	136.3	88.2	240.4	762.2
2018	264.7	124.6	91.2	226.7	706.1
2019	285.4	123.4	90.3	247.3	746.4
2020	285.2	135.0	*105*	*254.8*	*780*
2021	*305*	*145*	*110*	*260*	*820*

Calendar	EARNINGS PER SHARE A Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2017	1.40	.10	d.30	d3.14	d1.94
2018	1.46	d.01	d.39	1.27	2.33
2019	1.50	.07	d.61	1.26	2.19
2020	1.58	d.17	*d.40*	*1.34*	*2.35*
2021	*1.60*	*d.05*	*d.35*	*1.35*	*2.55*

Calendar	QUARTERLY DIVIDENDS PAID B ■ Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2016	.4675	.4675	.4675	.470	1.87
2017	.470	.470	.470	.4725	1.88
2018	.4725	.4725	.4725	.475	1.89
2019	.475	.475	.475	.4775	1.90
2020	.4775	.4775	.4775		

BUSINESS: Northwest Natural Holding Co. distributes natural gas to 1000 communities, 750,000 customers, in Oregon (89% of customers) and in southwest Washington state. Principal cities served: Portland and Eugene, OR; Vancouver, WA. Service area population: 3.7 mill. (77% in OR). Company buys gas supply from Canadian and U.S. producers; has transportation rights on Northwest Pipeline system. Owns local underground storage. Rev. breakdown: residential, 37%; commercial, 22%; industrial, gas transportation, 41%. Employs 1,167. BlackRock Inc. owns 15.5% of shares; Off./Dir. own less than 1% (4/20 proxy). CEO: David H. Anderson. Inc.: Oregon. Address: 220 NW 2nd Ave., Portland, OR 97209. Tel.: 503-226-4211. Internet: www.nwnatural.com.

Northwest Natural Holding recorded mixed second-quarter results. Revenues expanded to $135.0 million, aided by additional contributions from the North Mist natural gas storage facility and its recently acquired water operations. It added around 13,000 new customers over the past 12 months, growing its base by 1.7%. However, the company incurred higher gas costs and maintenance expenses. Moreover, interest expense rose due to a higher debt load, but a tax benefit helped some. Overall, these factors led to a net loss of $0.17 per share during the quarter. Still, the utility ought to have better results in the coming months, as it will likely benefit from new legislation in Oregon. This allows utilities to recover 5% of renewable natural gas' incremental costs, which would equate to about $30 million annually. Additionally, the company filed for a $45.8 million increase in revenues with the Oregon Public Utility Commission. If approved, this would take effect in November, though we don't think it will earn the full amount. Northwest sold about 1.4 million shares in June, which will spread profits among a higher total share count. Overall, we have reduced our 2020 full-year share-net estimate by a dime to $2.35.

The long-term outlook is bright here. Revenues will likely expand at a steady clip, assuming the company's rate cases yield favorable outcomes. Moreover, the entry into the water utility space should further enhance the top line as it closed several new water utility transactions. These include Suncadia in Washington State and its first water utility in Texas. Too, Northwest closed on a few water utilities in Idaho and will likely see some economies of scale emerge over the long haul. We project that earnings will expand to $2.55 per share in 2021 and $3.20 per share by mid-decade.

Shares of Northwest Natural Holding are neutrally ranked for Timeliness. This equity holds ample 3- to 5-year recovery potential based on our projections. Too, the dividend yield is attractive, though we expect modest increases in the payout in the years ahead. Overall, we think this equity will appeal to connservative long-term accounts.

John E. Seibert III *August 28, 2020*

(A) Diluted earnings per share. Excludes nonrecurring items: '06, ($0.06); '08, ($0.03); '09, $0.06; May not sum due to rounding. Next earnings report due in early November.
(B) Dividends historically paid in mid-February, May, August, and November.
■ Dividend reinvestment plan available.
(C) In millions.
(D) Includes intangibles. In 2019: $343.2 million, $11.26/share.

Company's Financial Strength	A
Stock's Price Stability	90
Price Growth Persistence	40
Earnings Predictability	5

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ONE GAS, INC. NYSE-OGS

RECENT PRICE	P/E RATIO	RELATIVE P/E RATIO	DIV'D YLD	VALUE LINE
75.18	21.0 (Trailing: 21.5 Median: NMF)	0.95	3.0%	

TIMELINESS 3 Lowered 2/28/20
SAFETY 2 New 6/2/17
TECHNICAL 3 Raised 5/8/20
BETA .80 (1.00 = Market)

18-Month Target Price Range

Low-High	Midpoint (% to Mid)
$60-$131	$96 (25%)

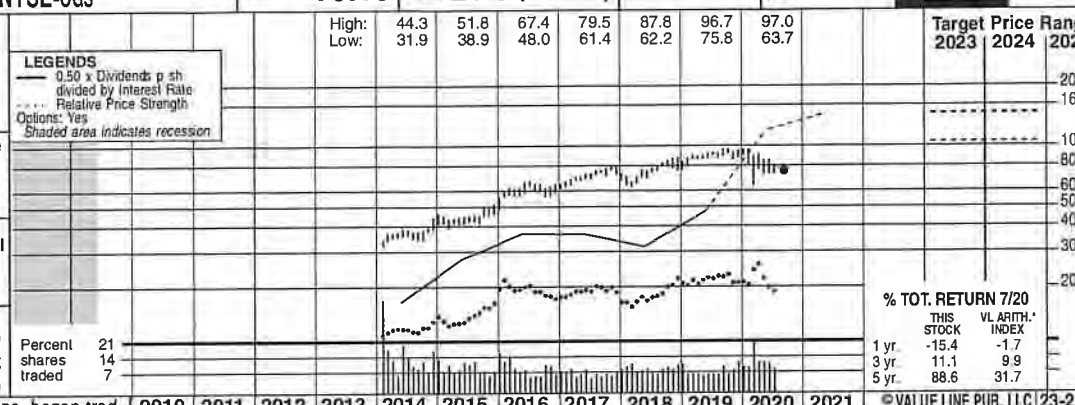
2023-25 PROJECTIONS

	Price	Gain	Ann'l Total Return
High	145	(+95%)	20%
Low	105	(+40%)	11%

Institutional Decisions

	3Q2019	4Q2019	1Q2020
to Buy	133	153	124
to Sell	132	132	157
Hld's(000)	40475	41714	41769

LEGENDS
0.50 x Dividends p sh divided by Interest Rate
Relative Price Strength
Options: Yes
Shaded area indicates recession



% TOT. RETURN 7/20

	THIS STOCK	VL ARITH.* INDEX
1 yr.	-15.4	-1.7
3 yr.	11.1	9.9
5 yr.	88.6	31.7

The shares of ONE Gas, Inc. began trading "regular-way" on the New York Stock Exchange on February 3, 2014. That happened as a result of the separation of ONEOK's natural gas distribution operation. Regarding the details of the spinoff, on January 31, 2014, ONEOK distributed one share of OGS common stock for every four shares of ONEOK common stock held by ONEOK shareholders of record as of the close of business on January 21. It should be mentioned that ONEOK did not retain any ownership interest in the new company.

CAPITAL STRUCTURE as of 6/30/20
Total Debt $1812.4 mill. **Due In 5 Yrs** $1150.0 mill.
LT Debt $1581.9 mill. **LT Interest** $85.0 mill.
(LT interest earned: 4.7x; total interest coverage: 4.7x)
Leases, Uncapitalized Annual rentals $7.6 mill.
Pfd Stock None
Pension Assets-12/19 $908.0 mill.
Oblig. $1001.4 mill.
Common Stock 52,920,531 shs.
as of 7/20/20
MARKET CAP: $4.0 billion (Mid Cap)

CURRENT POSITION ($MILL.)	2018	2019	6/30/20
Cash Assets	21.3	17.9	10.5
Other	522.0	488.3	336.9
Current Assets	543.3	506.2	347.4
Accts Payable	174.5	120.5	62.7
Debt Due	299.5	516.5	230.5
Other	224.9	235.7	197.6
Current Liab.	698.9	872.7	490.8
Fix. Chg. Cov.	677%	567%	560%

ANNUAL RATES of change (per sh)	Past 10 Yrs.	Past 5 Yrs.	Est'd '17-'19 to '23-'25
Revenues	--	-2.5%	4.5%
"Cash Flow"	--	7.0%	7.0%
Earnings	--	9.5%	6.5%
Dividends	--	17.0%	7.5%
Book Value	--	2.5%	5.5%

Calendar	QUARTERLY REVENUES ($ mill.) Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2017	550.4	279.7	247.1	462.4	1539.6
2018	638.5	292.5	238.3	464.4	1633.7
2019	661.0	290.6	248.6	452.5	1652.7
2020	528.2	273.3	*245*	*453.5*	*1500*
2021	*590*	*310*	*255*	*460*	*1615*

Calendar	EARNINGS PER SHARE A Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2017	1.34	.39	.36	.93	3.02
2018	1.72	.39	.31	.83	3.25
2019	1.76	.46	.33	.96	3.51
2020	1.72	.48	*.33*	*.97*	*3.50*
2021	*1.80*	*.50*	*.36*	*.99*	*3.65*

Calendar	QUARTERLY DIVIDENDS PAID B■ Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2016	.35	.35	.35	.35	1.40
2017	.42	.42	.42	.42	1.68
2018	.46	.46	.46	.46	1.84
2019	.50	.50	.50	.50	2.00
2020	.54	.54	.54		

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	©VALUE LINE PUB. LLC	23-25
	--	--	--	--	34.92	29.62	27.30	29.43	31.08	31.32	*28.30*	*30.20*	Revenues per sh	*40.00*
	--	--	--	--	4.52	4.82	5.43	5.96	6.32	6.96	*7.10*	*7.55*	"Cash Flow" per sh	*9.65*
	--	--	--	--	2.07	2.24	2.65	3.02	3.25	3.51	*3.50*	*3.65*	Earnings per sh A	*4.75*
	--	--	--	--	.84	1.20	1.40	1.68	1.84	2.00	*2.16*	*2.32*	Div'ds Decl'd per sh B■	*2.80*
	--	--	--	--	5.70	5.63	5.91	6.81	7.50	7.91	*8.80*	*8.95*	Cap'l Spending per sh	*9.35*
	--	--	--	--	34.45	35.24	36.12	37.47	38.86	40.35	*44.15*	*45.80*	Book Value per sh	*54.10*
	--	--	--	--	52.08	52.26	52.28	52.31	52.57	52.77	*53.00*	*53.50*	Common Shs Outst'g C	*55.00*
	--	--	--	--	17.8	19.8	22.7	23.5	23.1	25.3	*Bold figures are Value Line estimates*		Avg Ann'l P/E Ratio	*26.5*
	--	--	--	--	.94	1.00	1.19	1.18	1.25	1.37			Relative P/E Ratio	*1.45*
	--	--	--	--	2.3%	2.7%	2.3%	2.4%	2.5%	2.3%			Avg Ann'l Div'd Yield	*2.2%*
	--	--	--	--	1818.9	1547.7	1427.2	1539.6	1633.7	1652.7	*1500*	*1615*	Revenues ($mill)	*2200*
	--	--	--	--	109.8	119.0	140.1	159.9	172.2	186.7	*185*	*195*	Net Profit ($mill)	*260*
	--	--	--	--	38.4%	38.0%	37.8%	36.4%	23.7%	18.7%	*19.0%*	*19.5%*	Income Tax Rate	*22.0%*
	--	--	--	--	6.0%	7.7%	9.8%	10.4%	10.5%	11.3%	*12.3%*	*12.1%*	Net Profit Margin	*11.8%*
	--	--	--	--	40.1%	39.5%	38.7%	37.8%	38.6%	37.7%	*40.0%*	*40.0%*	Long-Term Debt Ratio	*38.0%*
	--	--	--	--	59.9%	60.5%	61.3%	62.2%	61.4%	62.3%	*60.0%*	*60.0%*	Common Equity Ratio	*62.0%*
	--	--	--	--	2995.3	3042.9	3080.7	3153.5	3328.1	3415.5	*3900*	*4085*	Total Capital ($mill)	*4800*
	--	--	--	--	3293.7	3511.9	3731.6	4007.6	4283.7	4565.2	*4800*	*5030*	Net Plant ($mill)	*5750*
	--	--	--	--	4.4%	4.7%	5.2%	5.8%	5.9%	6.4%	*6.0%*	*6.0%*	Return on Total Cap'l	*6.5%*
	--	--	--	--	6.1%	6.5%	7.4%	8.2%	8.4%	8.8%	*8.0%*	*8.0%*	Return on Shr. Equity	*8.5%*
	--	--	--	--	6.1%	6.5%	7.4%	8.2%	8.4%	8.8%	*8.0%*	*8.0%*	Return on Com Equity	*8.5%*
	--	--	--	--	3.7%	3.1%	3.5%	3.7%	3.7%	3.8%	*3.0%*	*3.0%*	Retained to Com Eq	*3.5%*
	--	--	--	--	40%	53%	52%	55%	56%	56%	*62%*	*64%*	All Div'ds to Net Prof	*59%*

BUSINESS: ONE Gas, Inc. provides natural gas distribution services to more than two million customers. There are three divisions: Oklahoma Natural Gas, Kansas Gas Service, and Texas Gas Service. The company purchased 174 Bcf of natural gas supply in 2019, compared to 180 Bcf in 2018. Total volumes delivered by customer (fiscal 2019): transportation, 56.6%; residential, 32.5%; commercial & industrial, 10.3%; other, .6%. ONE Gas has around 3,600 employees. BlackRock owns 12.1% of common stock; The Vanguard Group, 10.1%; T. Rowe Price Associates, 7.0%; officers and directors, 1.9% (4/20 Proxy). CEO: Pierce H. Norton II. Incorporated: Oklahoma. Address: 15 East Fifth Street, Tulsa, Oklahoma 74103. Tel.: 918-947-7000. Internet: www.onegas.com.

ONE Gas, Inc. posted lackluster results through the first half of 2020. Profits of $2.20 per share were a couple of pennies lower than last year's $2.22 total. That can be traced, to a certain degree, to diminished gas sales, net of weather normalization, primarily in Kansas and Oklahoma because of warmer weather. Also, there was a decrease in transportation volumes in Kansas as well as a higher effective income tax rate.

Prospects over the remaining six months don't appear exciting, either. The coronavirus is having an unfavorable impact on results. However, the effects are being partially offset by regulatory actions enabling the company to use an accounting mechanism to accumulate and defer certain incremental costs incurred (including bad-debt expenses) and lost revenues in connection with the pandemic. Moreover, leadership implemented a comprehensive set of procedures to protect the safety of employees and customers. Even so, it seems that full-year earnings will be around $3.50 a share, flat relative to the 2019 tally of $3.51. But concerning 2021, the bottom line stands to increase 4% or so, to $3.65 a share, assuming that COVID-19 is largely under control.

This year's capital expenditures, including asset removal costs, are now anticipated to lie between $500 million and $525 million. (That's above both the initial $475 million target and the 2019 amount of $465 million.) The increase is attributed mainly to the extension of service to new customers. Around 70% of the funds are being utilized for system integrity and pipeline replacement projects. We believe that corporate finances are quite sufficient to make those initiatives possible. Notably, leadership expects the spending budget to range between $475 million and $525 million annually during the 2020-2024 period, with roughly the same percentage of capital allocated to where it is at present.

The equity has some appealing attributes. Capital gains potential in the 18-month period and out to mid-decade looks solid. Consider, also, the dividend growth prospects, although the yield does not stand out compared to the average of *Value Line's* Natural Gas Utility group.

Frederick L. Harris, III *August 28, 2020*

(A) Diluted EPS. Excludes nonrecurring gain: 2017, $0.06. Next earnings report due early Nov. Quarterly EPS for 2018 don't add up due to rounding.

(B) Dividends historically paid in early March, June, Sept., and Dec. ■ Dividend reinvestment plan. Direct stock purchase plan.

(C) In millions.

Company's Financial Strength	A
Stock's Price Stability	95
Price Growth Persistence	100
Earnings Predictability	95

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SOUTH JERSEY INDS. NYSE-SJI

RECENT PRICE	P/E RATIO	RELATIVE P/E RATIO	DIV'D YLD	VALUE LINE
24.14	15.6 (Trailing: 18.6 / Median: 19.0)	0.71	5.1%	

TIMELINESS 3 Lowered 7/20/18
SAFETY 3 Lowered 8/28/20
TECHNICAL 3 Raised 4/24/20
BETA 1.00 (1.00 = Market)

18-Month Target Price Range

Low-High	Midpoint (% to Mid)
$18-$50	$34 (40%)

2023-25 PROJECTIONS

	Price	Gain	Ann'l Total Return
High	45	(+85%)	*20%*
Low	35	(+45%)	*14%*

Institutional Decisions

	3Q2019	4Q2019	1Q2020
to Buy	101	124	108
to Sell	100	95	125
Hld's(000)	77210	79196	78322

	High:	Low:
2004	14.75	12.22
2005	15.89	12.25
2006	15.88	12.75
2007	16.15	12.79
2008	16.18	12.74
2009	14.19	12.86
2010	15.48	12.79
2011	13.71	11.16
2012	11.16	11.18
2013	11.18	12.98
2014	12.98	13.52
2015	13.52	13.04
2016	13.04	15.63
2017	15.63	19.20
2018	19.20	17.63
2019	17.63	*15.25*
2020	*15.25*	*16.30*
2021	*16.30*	

LEGENDS
0.45 x Dividends p sh divided by Interest Rate
Relative Price Strength
2-for-1 split 5/15
Options: Yes
Shaded area indicates recession

Target Price Range 2023 | 2024 | 2025

% TOT. RETURN 7/20

	THIS STOCK	VL ARITH.* INDEX
1 yr.	-28.7	-1.7
3 yr.	-23.3	9.9
5 yr.	15.7	31.7

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	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	
	14.75	15.89	15.88	16.15	16.18	14.19	15.48	13.71	11.16	11.18	12.98	13.52	13.04	15.63	19.20	17.63	*15.25*	*16.30*	Revenues per sh
	1.22	1.25	1.75	1.60	1.74	1.86	2.10	2.23	2.34	2.48	2.67	2.42	2.67	2.79	2.91	2.56	*2.50*	*2.80*	"Cash Flow" per sh
	.79	.86	1.23	1.05	1.14	1.19	1.35	1.45	1.52	1.52	1.57	1.44	1.34	1.23	1.38	1.12	*1.50*	*1.70*	Earnings per sh A
	.41	.43	.46	.51	.56	.61	.68	.75	.83	.90	.96	1.02	1.06	1.10	1.13	1.16	*1.20*	*1.25*	Div'ds Decl'd per sh B■
	1.34	1.60	1.26	.94	1.04	1.83	2.79	3.20	4.01	4.84	5.01	4.87	3.50	3.43	3.99	5.46	*5.45*	*5.85*	Cap'l Spending per sh
	6.20	6.75	7.55	8.12	8.67	9.12	9.54	10.33	11.63	12.64	13.65	14.62	16.22	14.99	14.82	15.41	*16.60*	*17.25*	Book Value per sh C
	55.52	57.96	58.65	59.22	59.46	59.59	59.75	60.43	63.31	65.43	68.33	70.97	79.48	79.55	85.51	92.39	*101.00*	*103.00*	Common Shs Outst'g D
	14.1	16.6	11.9	17.2	15.9	15.0	16.8	18.4	16.9	18.9	18.0	17.9	21.7	27.9	22.6	28.3	*Bold figures are*		Avg Ann'l P/E Ratio
	.74	.88	.64	.91	.96	1.00	1.07	1.15	1.08	1.06	.95	.90	1.14	1.40	1.22	1.53	*Value Line*		Relative P/E Ratio
	3.7%	3.0%	3.2%	2.8%	3.1%	3.4%	3.0%	2.8%	3.2%	3.1%	3.4%	3.9%	3.6%	3.2%	3.6%	3.7%	*estimates*		Avg Ann'l Div'd Yield
							925.1	828.6	706.3	731.4	887.0	959.6	1036.5	1243.1	1641.3	1628.6	*1540*	*1680*	Revenues ($mill)
							81.0	87.0	93.3	97.1	104.0	99.0	102.8	98.1	116.2	103.0	*145*	*170*	Net Profit ($mill)
							15.2%	22.4%	10.8%	--	--	5.9%	42.0%	--	--	22.0%	*25.0%*	*21.0%*	Income Tax Rate
							8.8%	10.5%	13.2%	13.3%	11.7%	10.3%	9.9%	7.9%	7.1%	6.3%	*9.4%*	*10.1%*	Net Profit Margin
							37.4%	40.5%	45.0%	45.1%	48.0%	49.2%	38.5%	48.5%	62.4%	59.2%	*61.0%*	*61.0%*	Long-Term Debt Ratio
							62.6%	59.5%	55.0%	54.9%	52.0%	50.8%	61.5%	51.5%	37.6%	40.8%	*39.0%*	*39.0%*	Common Equity Ratio
							910.1	1048.3	1337.6	1507.4	1791.9	2043.9	2097.2	2315.4	3373.9	3493.9	*4275*	*4575*	Total Capital ($mill)
							1193.3	1352.4	1578.0	1859.1	2134.1	2448.1	2623.8	2700.2	3653.5	4073.5	*4350*	*4700*	Net Plant ($mill)
							9.5%	8.9%	7.4%	6.8%	6.4%	5.4%	5.4%	5.1%	4.4%	4.0%	*4.5%*	*5.0%*	Return on Total Cap'l
							14.2%	13.9%	12.7%	11.7%	11.2%	9.5%	8.0%	8.2%	9.2%	7.2%	*8.5%*	*9.5%*	Return on Shr. Equity
							14.2%	13.9%	12.7%	11.7%	11.2%	9.5%	8.0%	8.2%	9.2%	7.2%	*8.5%*	*9.5%*	Return on Com Equity
							7.1%	6.7%	5.8%	4.8%	4.3%	2.8%	1.6%	.9%	1.7%	NMF	*1.5%*	*2.5%*	Retained to Com Eq
							50%	52%	55%	59%	61%	71%	80%	89%	82%	104%	*84%*	*76%*	All Div'ds to Net Prof

	23-25
Revenues per sh	*19.55*
"Cash Flow" per sh	*3.85*
Earnings per sh A	*2.50*
Div'ds Decl'd per sh B■	*1.40*
Cap'l Spending per sh	*7.25*
Book Value per sh C	*20.45*
Common Shs Outst'g D	*110.00*
Avg Ann'l P/E Ratio	*16.0*
Relative P/E Ratio	*.90*
Avg Ann'l Div'd Yield	*3.5%*
Revenues ($mill)	*2150*
Net Profit ($mill)	*275*
Income Tax Rate	*21.0%*
Net Profit Margin	*12.8%*
Long-Term Debt Ratio	*59.0%*
Common Equity Ratio	*41.0%*
Total Capital ($mill)	*5500*
Net Plant ($mill)	*5600*
Return on Total Cap'l	*6.0%*
Return on Shr. Equity	*12.0%*
Return on Com Equity	*12.0%*
Retained to Com Eq	*5.5%*
All Div'ds to Net Prof	*56%*

CAPITAL STRUCTURE as of 6/30/20
Total Debt $3137.1 mill. Due in 5 Yrs $1045 mill.
LT Debt $2566.4 mill. LT Interest $95.0 mill.

Leases, Uncapitalized Annual rentals $1.2 mill.
Pension Assets-12/19 $312.5 mill.
Oblig. $439.4 mill.

Pfd Stock None

Common Stock 100,586,050 shs.
as of 8/1/20

MARKET CAP: $2.4 billion (Mid Cap)

CURRENT POSITION ($MILL.)	2018	2019	6/30/20
Cash Assets	30.0	6.4	7.3
Other	633.2	646.1	415.5
Current Assets	663.2	652.5	422.8
Accts Payable	410.5	232.2	160.4
Debt Due	1004.4	1316.6	570.7
Other	165.9	183.1	195.1
Current Liab.	1580.8	1731.9	926.2
Fix. Chg. Cov.	112%	176%	206%

ANNUAL RATES of change (per sh)	Past 10 Yrs.	Past 5 Yrs.	Est'd '17-'19 to '23-'25
Revenues	--	6.0%	*2.0%*
"Cash Flow"	5.0%	3.5%	*6.0%*
Earnings	1.5%	-2.5%	*12.5%*
Dividends	8.0%	6.0%	*3.5%*
Book Value	6.5%	6.0%	*5.0%*

Calendar	QUARTERLY REVENUES ($ mill.) Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2017	425.8	244.4	227.1	345.8	1243.1
2018	521.9	227.3	302.5	589.6	1641.3
2019	637.3	266.9	261.2	463.2	1628.6
2020	534.1	260.0	*260.0*	*485.9*	*1540*
2021	*575*	*285*	*290*	*530*	*1680*

Calendar	EARNINGS PER SHARE A Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2017	.72	.06	d.05	.50	1.23
2018	1.19	.07	d.27	.39	1.38
2019	1.09	d.13	d.30	.46	1.12
2020	1.15	d.01	*d.20*	*.56*	*1.50*
2021	*1.20*	*.05*	*d.15*	*.60*	*1.70*

Calendar	QUARTERLY DIVIDENDS PAID B■ Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2016	--	.264	.264	.536	1.06
2017	--	.273	.273	.553	1.10
2018	--	.280	.280	.567	1.13
2019	--	.287	.287	.582	1.16
2020	--	.295	295		

BUSINESS: South Jersey Industries, Inc. is a holding company. The company distributes natural gas in New Jersey and Maryland. South Jersey Gas rev. mix '19: residential, 47%; commercial, 23%; cogen. and electric gen., 12%; industrial, 18%. Acq. Elizabethtown Gas and Elkton Gas, 7/18. Nonutil. operations include South Jersey Energy, South Jersey Resources Group, South Jersey Exploration, Marina Energy, South Jersey Energy Service Plus, and SJI Midstream. Has about 1,100 employees. Off./dir. own less than 1% of common; BlackRock, 15.5%; The Vanguard Group, 11.4% (3/20 proxy). Pres. & CEO: Michael J. Renna. Chairman: Joseph M. Rigby. Inc.: NJ. Addr.: 1 South Jersey Plaza, Folsom, NJ 08037. Tel.: 609-561-9000. Internet: www.sjindustries.com.

Shares of South Jersey Industries have declined in price lately. The company has posted mixed results in recent periods. Revenue comparisons have not been favorable, but the bottom line has fared better. In the June quarter, the top line fell modestly, year over year. But expenses remained in check, and the share deficit narrowed to $0.01. Looking forward, we expect that considerable economic weakness due to restrictive social measures implemented to curb the spread of the coronavirus will constrain the top line in the back half of the year, though we do envision a measure of improvement in the December period. Earnings comparisons will likely remain favorable, assuming lower cost of sales. All things considered, we project a moderate top-line pullback but a strong share-earnings advance for South Jersey for full-year 2020.

The company recently completed an equity offering. South Jersey received gross proceeds of about $200 million in an at-the-market offering. This transaction was completed in mid-June, and satisfies the company's plan to raise equity capital this year. The share count has increased moderately as a result.

We envision further operating improvement here from 2020 onward. The company's utility operations and regulatory initiatives should continue to fare well. Its businesses should further benefit from growth in the customer base. Infrastructure investments will allow the company to modernize its system and meet growing demand for natural gas within its service territories. Infrastructure replacement programs allow South Jersey to earn an authorized return on approved investments. We anticipate better results on the nonutility side, as well.

This neutrally ranked stock has ample investment appeal. We anticipate solid bottom-line growth for the company over the pull to mid-decade. From the recent quotation, this equity offers worthwhile long-term total return potential. This is helped by a generous dividend yield. Moreover, South Jersey Industries earns fairly good marks for Price Stability and Earnings Predictability. Subscribers seeking exposure to the utility space might want to take a closer look.

Michael Napoli, CFA *August 28, 2020*

Company's Financial Strength	B++
Stock's Price Stability	70
Price Growth Persistence	20
Earnings Predictability	65

(A) Based on economic egs. from 2007. GAAP EPS: '08, $1.29; '09, $0.97; '10, $1.11; '11, $1.49; '12, $1.49; '13, $1.28; '14, $1.46; '15, $1.52; '16, $1.56; '17, ($0.04); '18, $0.21; '19, $0.84. Excl. nonrecur. gain (loss): '09, ($0.22); '10, ($0.24); '11, $0.04; '12, ($0.03); '13, ($0.24); '14, ($0.11); '15, $0.08; '16, $0.22; '17, ($1.27); '18, ($1.17); '19, ($0.28). Next egs. rpt. due early November. (B) Div'ds paid early April, July, Oct., and late Dec. ■ Div. reinvest. plan avail. (C) Incl. reg. assets. In 2019: $665.9 mill., $7.21 per shr. (D) In mill., adj. for split.

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SPIRE INC. NYSE-SR

RECENT PRICE 60.54 | P/E RATIO NMF (Trailing: 51.7, Median: 18.0) | RELATIVE P/E RATIO NMF | DIV'D YLD 4.3% | VALUE LINE

TIMELINESS 3 Lowered 11/30/18
SAFETY 2 Raised 6/20/03
TECHNICAL 3 Raised 5/1/20
BETA .80 (1.00 = Market)

18-Month Target Price Range

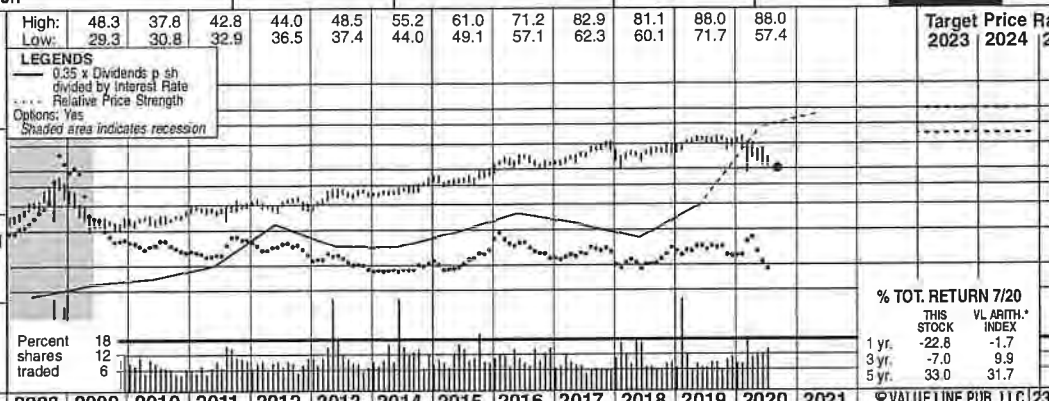
Low-High	Midpoint (% to Mid)
$53-$117	$85 (40%)

2023-25 PROJECTIONS

	Price	Gain	Ann'l Total Return
High	120	(+100%)	21%
Low	90	(+50%)	13%

Institutional Decisions

	3Q2019	4Q2019	1Q2020
to Buy	115	127	120
to Sell	117	114	116
Hld's(000)	41800	42195	42039



2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	©VALUE LINE PUB. LLC	23-25
59.59	75.43	93.51	93.40	100.44	85.49	77.83	71.48	49.90	31.10	37.68	45.59	33.68	36.07	38.78	38.30	*35.10*	*36.40*	Revenues per sh [A]	*58.20*
2.79	2.98	3.81	3.87	4.22	4.56	4.11	4.62	4.58	3.12	3.87	6.15	6.16	6.54	7.55	7.12	*4.70*	*7.25*	"Cash Flow" per sh	*9.75*
1.82	1.90	2.37	2.31	2.64	2.92	2.43	2.86	2.79	2.02	2.35	3.16	3.24	3.43	4.33	3.52	*1.10*	*3.30*	Earnings per sh [A B]	*5.15*
1.35	1.37	1.40	1.45	1.49	1.53	1.57	1.61	1.66	1.70	1.76	1.84	1.96	2.10	2.25	2.37	*2.49*	*2.61*	Div'ds Decl'd per sh [C ■]	*3.00*
2.45	2.84	2.97	2.72	2.57	2.36	2.56	3.02	4.83	4.00	3.96	6.68	6.42	9.08	9.86	16.15	*12.50*	*10.10*	Cap'l Spending per sh	*10.50*
16.96	17.31	18.85	19.79	22.12	23.32	24.02	25.56	26.67	32.00	34.93	36.30	38.73	41.26	44.51	45.14	*50.50*	*55.45*	Book Value per sh [D]	*72.00*
20.98	21.17	21.36	21.65	21.99	22.17	22.29	22.43	22.55	32.70	43.18	43.36	45.65	48.26	50.67	50.97	*52.00*	*52.50*	Common Shs Outst'g [E]	*55.00*
15.7	16.2	13.6	14.2	14.3	13.4	13.7	13.0	14.5	21.3	19.8	16.5	19.6	19.8	16.7	22.8	*Bold figures are Value Line estimates*		Avg Ann'l P/E Ratio	*20.5*
.83	.86	.73	.75	.86	.89	.87	.82	.92	1.20	1.04	.83	1.03	1.00	.90	1.24			Relative P/E Ratio	*1.15*
4.7%	4.4%	4.3%	4.4%	3.9%	3.9%	4.7%	4.3%	4.1%	4.0%	3.8%	3.5%	3.1%	3.1%	3.1%	3.0%			Avg Ann'l Div'd Yield	*2.9%*
1735.0	1603.3	1125.5	1017.0	1627.2	1976.4	1537.3	1740.7	1965.0	1952.4	*1825*	*1910*	Revenues ($mill) [A]	*3200*
54.0	63.8	62.6	52.8	84.6	136.9	144.2	161.6	214.2	184.6	*55.0*	*175*	Net Profit ($mill)	*285*
33.4%	31.4%	29.6%	25.0%	27.6%	31.2%	32.5%	32.4%	32.4%	15.7%	*15.0%*	*16.0%*	Income Tax Rate	*23.5%*
3.1%	4.0%	5.6%	5.2%	5.2%	6.9%	9.4%	9.3%	10.9%	9.5%	*3.0%*	*9.2%*	Net Profit Margin	*8.9%*
40.5%	38.9%	36.1%	46.6%	55.1%	53.0%	50.9%	50.0%	45.7%	45.0%	*49.0%*	*48.0%*	Long-Term Debt Ratio	*45.0%*
59.5%	61.1%	63.9%	53.4%	44.9%	47.0%	49.1%	50.0%	54.3%	55.0%	*51.0%*	*52.0%*	Common Equity Ratio	*55.0%*
899.9	937.7	941.0	1959.0	3359.4	3345.1	3601.9	3986.3	4155.5	4625.6	*5150*	*5600*	Total Capital ($mill)	*7200*
884.1	928.7	1019.3	1776.6	2759.7	2941.2	3300.9	3665.2	3970.5	4352.0	*4650*	*5070*	Net Plant ($mill)	*6500*
7.4%	8.1%	7.9%	3.3%	3.1%	5.1%	4.9%	5.0%	6.3%	5.1%	*2.5%*	*4.5%*	Return on Total Cap'l	*5.5%*
10.1%	11.1%	10.4%	5.0%	5.6%	8.7%	8.2%	8.1%	9.5%	7.3%	*2.0%*	*6.0%*	Return on Shr. Equity	*7.0%*
10.1%	11.1%	10.4%	5.0%	5.6%	8.7%	8.2%	8.1%	9.5%	7.9%	*2.0%*	*6.0%*	Return on Com Equity	*7.0%*
3.6%	4.9%	4.3%	1.0%	1.5%	3.7%	3.3%	3.3%	4.7%	2.7%	*NMF*	*1.0%*	Retained to Com Eq	*3.0%*
64%	56%	59%	81%	73%	58%	59%	60%	51%	66%	*NMF*	*80%*	All Div'ds to Net Prof	*60%*

CAPITAL STRUCTURE as of 6/30/20
Total Debt $2961.3 mill. **Due in 5 Yrs** $725.0 mill.
LT Debt $2478.3 mill. **LT Interest** $120.0 mill.
(Total interest coverage: 3.1x)

Leases, Uncapitalized Annual rentals $8.2 mill.
Pension Assets-9/19 $521.8 mill.
Oblig. $751.4 mill.
Pfd Stock $242.0 mill. **Pfd Div'd** $3.4 mill.
Common Stock 51,482,424 shs.
as of 7/31/20

MARKET CAP: $3.1 billion (Mid Cap)

CURRENT POSITION ($MILL.)	2018	2019	6/30/20
Cash Assets	4.4	5.8	7.4
Other	655.2	608.7	551.9
Current Assets	659.6	614.5	559.3
Accts Payable	290.1	301.5	200.8
Debt Due	729.1	783.2	483.0
Other	302.5	384.1	424.0
Current Liab.	1321.7	1468.8	1107.6
Fix. Chg. Cov.	284%	272%	275%

ANNUAL RATES of change (per sh)	Past 10 Yrs.	Past 5 Yrs.	Est'd '17-'19 to '23-'25
Revenues	-8.5%	-1.0%	*7.5%*
"Cash Flow"	5.5%	13.0%	*5.5%*
Earnings	3.5%	9.5%	*5.5%*
Dividends	4.0%	5.5%	*5.0%*
Book Value	7.0%	7.0%	*8.5%*

Fiscal Year Ends	QUARTERLY REVENUES ($ mill.) [A] Dec.31	Mar.31	Jun.30	Sep.30	Full Fiscal Year
2017	495.1	663.4	323.5	258.7	1740.7
2018	561.8	813.4	350.6	239.2	1965.0
2019	602.0	803.5	321.3	225.6	1952.4
2020	566.9	715.5	321.1	*221.5*	*1825*
2021	*580*	*760*	*340*	*230*	*1910*

Fiscal Year Ends	EARNINGS PER SHARE [A B F] Dec.31	Mar.31	Jun.30	Sep.30	Full Fiscal Year
2017	.99	2.36	.45	d.28	3.43
2018	2.39	2.03	.52	d.51	4.33
2019	1.32	3.04	d.09	d.74	3.52
2020	1.24	2.54	d1.87	*d.81*	*1.10*
2021	*1.27*	*2.61*	*.20*	*d.78*	*3.30*

Cal-endar	QUARTERLY DIVIDENDS PAID [C ■] Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2016	.49	.49	.49	.49	1.96
2017	.525	.525	.525	.525	2.10
2018	.5625	.5625	.5625	.5625	2.25
2019	.5925	.5925	.5925	.5925	2.37
2020	.6225	.6225	.6225		

BUSINESS: Spire Inc., formerly known as the Laclede Group, Inc., is a holding company for natural gas utilities, which distributes natural gas across Missouri, including the cities of St. Louis and Kansas City, Alabama, and Mississippi. Has roughly 1.8 million customers. Acquired Missouri Gas 9/13, Alabama Gas Co 9/14. Utility therms sold and transported in fiscal 2019: 3.4 bill. Revenue mix for regulated operations: residential, 68%; commercial and industrial, 23%; transportation, 6%; other, 3%. Has about 3,536 employees. Officers and directors own 2.9% of common shares; BlackRock, 15.0% (1/20 proxy). Chairman: Edward Glotzbach; CEO: Suzanne Sitherwood. Inc.: Missouri. Address: 700 Market Street, St. Louis, Missouri 63101. Tel.: 314-342-0500. Internet: www.spireenergy.com.

Spire Inc. is about to close the books on a disappointing fiscal 2020 (ends September 30th). Through the first nine months, share net plunged 55%, to $1.91, relative to last year's $4.27 tally. This reflects the impact of the pandemic, which began to have an increasingly greater effect on the company as the months progressed. Notably, in the third quarter, it incurred a total pre-tax impairment charge of $148.6 million, equal to $2.29 a share aftertax, due primarily to the writedown of the value of storage assets and, to a lesser degree, two commercial compressed natural gas fueling stations. Spire contends, though, that it is pursuing operating efficiencies and potential regulatory mechanisms to help offset the damage from COVID-19. Unfortunately, it seems that profits for the entire year will still tumble nearly 70%, to $1.10 a share, versus the fiscal 2019 figure of $3.52. But assuming that the health crisis dissipates, the bottom line stands to recover threefold, to $3.30 a share, in fiscal 2021.

We are optimistic about the energy firm's business prospects out to mid-decade. The gas utilities boast 1.8 million customers in Mississippi, Alabama, and Missouri, providing a measure of regional diversity. Also, the other operations, especially pipelines, show promise. Additional expansionary projects and technological enhancements in customer service and elsewhere ought to help, too. Lastly, Spire's balance sheet is solid (see below).

The Financial Strength rating resides at B++. At the end of June, there was almost $650 million of available liquidity partly via a revolving credit facility. Too, long-term debt sat at a manageable 48% of total capital, and short-term obligations were not a big problem. So, the company should be able to satisfy its various commitments (including interest payments, capital expenditures, and dividends) for a while. Acquisitions are also plausible.

These good-quality shares have taken a major step backward in recent months. We think that price move stems partly from the company's weak third-quarter performance. But recovery potential out to mid-decade now looks appealing. Consider, too, the dividend yield and 18-month capital gains potential.

Frederick L. Harris, III *August 28, 2020*

(A) Fiscal year ends Sept. 30th. (B) Based on diluted shares outstanding. Excludes nonrecurring loss: '06, 7¢. Excludes gain from discontinued operations: '08, 94¢. Next earnings report due late Oct. (C) Dividends paid in early January, April, July, and October. ■ Dividend reinvestment plan available. (D) Incl. deferred charges. In '19: $1,171.6 mill., $22.99/sh. (E) In millions. (F) Qtly. egs. may not sum due to rounding or change in shares outstanding.

Company's Financial Strength	B++
Stock's Price Stability	95
Price Growth Persistence	75
Earnings Predictability	65

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SOUTHWEST GAS NYSE-SWX

RECENT PRICE **69.45** | P/E RATIO **16.2** (Trailing: 18.5 Median: 18.0) | RELATIVE P/E RATIO **0.74** | DIV'D YLD **3.3%** | **VALUE LINE**

TIMELINESS 3 Raised 3/20/20
SAFETY 3 Lowered 1/4/91
TECHNICAL 3 Raised 5/22/20
BETA .90 (1.00 = Market)

18-Month Target Price Range
Low-High **Midpoint (% to Mid)**
$52-$119 $86 (25%)

2023-25 PROJECTIONS

	Price	Gain	Ann'l Total Return
High	120	(+75%)	*17%*
Low	80	(+15%)	*7%*

Institutional Decisions

	3Q2019	4Q2019	1Q2020
to Buy	153	155	118
to Sell	122	136	155
Hld's(000)	45864	47563	47511

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	© VALUE LINE PUB. LLC	23-25
High:	29.5	37.3	43.2	46.1	56.0	64.2	63.7	79.6	86.9	86.0	92.9	81.6								
Low:	17.1	26.3	32.1	39.0	42.0	47.2	50.5	53.5	72.3	62.5	73.3	45.7								
	40.14	43.59	48.47	50.28	48.53	42.00	40.18	41.07	41.77	42.08	45.61	52.00	51.82	53.00	54.31	56.72	***56.60***	***59.00***	Revenues per sh	***65.40***
	5.57	5.20	5.97	6.21	5.76	6.16	6.46	6.81	7.73	8.24	8.47	8.62	9.29	8.83	8.14	9.40	***9.75***	***10.35***	"Cash Flow" per sh	***13.45***
	1.66	1.25	1.98	1.95	1.39	1.94	2.27	2.43	2.86	3.11	3.01	2.92	3.18	3.62	3.68	3.94	***3.85***	***4.35***	Earnings per sh [A]	***6.25***
	.82	.82	.82	.86	.90	.95	1.00	1.06	1.18	1.32	1.46	1.62	1.80	1.98	2.08	2.18	***2.26***	***2.35***	Div'ds Decl'd per sh [B■†]	***2.65***
	8.23	7.49	8.27	7.96	6.79	4.81	4.73	8.29	8.57	7.86	8.53	10.30	11.15	12.97	14.44	17.06	***15.45***	***17.80***	Cap'l Spending per sh	***21.55***
	19.18	19.10	21.58	22.98	23.49	24.44	25.62	26.66	28.35	30.47	31.95	33.61	35.03	37.74	42.47	45.56	***48.25***	***50.85***	Book Value per sh	***61.15***
	36.79	39.33	41.77	42.81	44.19	45.09	45.56	45.96	46.15	46.36	46.52	47.38	47.48	48.09	53.03	55.01	***57.00***	***59.00***	Common Shs Outst'g [C]	***65.00***
	14.3	20.6	15.9	17.3	20.3	12.2	14.0	15.7	15.0	15.8	17.9	19.4	21.6	22.2	20.6	21.3			Avg Ann'l P/E Ratio	***16.0***
	.76	1.10	.86	.92	1.22	.81	.89	.98	.95	.89	.94	.98	1.13	1.12	1.11	1.15			Relative P/E Ratio	***.90***
	3.5%	3.2%	2.6%	2.6%	3.2%	4.0%	3.2%	2.8%	2.8%	2.7%	2.7%	2.9%	2.6%	2.5%	2.7%	2.6%			Avg Ann'l Div'd Yield	***2.7%***
	1830.4	1887.2	1927.8	1950.8	2121.7	2463.6	2460.5	2548.8	2880.0	3119.9	***3225***	***3480***	Revenues ($mill)	***4250***
	103.9	112.3	133.3	145.3	141.1	138.3	152.0	173.8	182.3	213.9	***215***	***250***	Net Profit ($mill)	***395***
	34.7%	36.2%	36.2%	35.0%	35.7%	36.4%	33.9%	32.8%	25.3%	20.5%	***21.0%***	***21.0%***	Income Tax Rate	***21.0%***
	5.7%	6.0%	6.9%	7.4%	6.7%	5.6%	6.2%	6.8%	6.3%	6.9%	***6.7%***	***7.2%***	Net Profit Margin	***9.3%***
	49.1%	43.2%	49.2%	49.4%	52.4%	49.3%	48.2%	49.8%	48.3%	47.9%	***50.0%***	***50.0%***	Long-Term Debt Ratio	***44.5%***
	50.9%	56.8%	50.8%	50.6%	47.6%	50.7%	51.8%	50.2%	51.7%	52.1%	***50.0%***	***50.0%***	Common Equity Ratio	***55.5%***
	2291.7	2155.9	2576.9	2793.7	3123.9	3143.5	3213.5	3613.3	4359.3	4806.4	***5500***	***6000***	Total Capital ($mill)	***7175***
	3072.4	3218.9	3343.8	3486.1	3658.4	3891.1	4132.0	4523.7	5093.2	5685.2	***6000***	***6400***	Net Plant ($mill)	***7600***
	6.1%	6.4%	6.4%	6.3%	5.7%	5.5%	5.8%	5.8%	5.2%	5.4%	***5.0%***	***5.0%***	Return on Total Cap'l	***6.5%***
	8.9%	9.2%	10.2%	10.3%	9.5%	8.7%	9.1%	9.6%	8.1%	8.5%	***8.0%***	***8.5%***	Return on Shr. Equity	***10.0%***
	8.9%	9.2%	10.2%	10.3%	9.5%	8.7%	9.1%	9.6%	8.1%	8.5%	***8.0%***	***8.5%***	Return on Com Equity	***10.0%***
	5.1%	5.3%	6.1%	6.1%	5.0%	4.0%	4.1%	4.5%	3.6%	3.9%	***3.0%***	***3.5%***	Retained to Com Eq	***5.5%***
	43%	43%	40%	41%	47%	54%	55%	53%	55%	54%	***60%***	***55%***	All Div'ds to Net Prof	***44%***

Bold figures are Value Line estimates

% TOT. RETURN 7/20

	THIS STOCK	VL ARITH.* INDEX
1 yr.	-20.0	-1.7
3 yr.	-6.4	9.9
5 yr.	40.2	31.7

CAPITAL STRUCTURE as of 6/30/20
Total Debt $2869.0 mill. **Due in 5 Yrs** $898.8 mill.
LT Debt $2639.3 mill. **LT Interest** $100.0 mill.
(Total interest coverage: 3.4x) (49% of Cap'l)
Leases, Uncapitalized Annual rentals $13.0 mill.
Pension Assets-12/19 $1027.8 mill.
Oblig. $1405.7 mill.

Pfd Stock None

Common Stock 55,914,516 shs.
as of 7/31/20

MARKET CAP: $3.9 billion (Mid Cap)

CURRENT POSITION ($MILL.)	2018	2019	6/30/20
Cash Assets	85.4	49.5	199.6
Other	754.4	810.4	667.6
Current Assets	839.8	859.9	867.2
Accts Payable	249.0	238.9	189.4
Debt Due	185.1	374.5	229.7
Other	504.5	466.5	498.9
Current Liab.	938.6	1079.9	918.0
Fix. Chg. Cov.	370%	340%	354%

ANNUAL RATES of change (per sh)	Past 10 Yrs.	Past 5 Yrs.	Est'd '17-'19 to '23-'25
Revenues	1.5%	5.0%	*3.0%*
"Cash Flow"	4.0%	1.5%	*7.5%*
Earnings	8.0%	4.5%	*9.0%*
Dividends	8.5%	9.5%	*4.0%*
Book Value	6.0%	6.5%	*6.5%*

Calendar	QUARTERLY REVENUES ($ mill.) Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2017	654.7	560.5	593.2	740.4	2548.8
2018	754.3	670.9	668.1	786.7	2880.0
2019	833.6	713.0	725.2	848.1	3119.9
2020	836.3	757.2	***760***	***871.5***	***3225***
2021	***890***	***825***	***825***	***940***	***3480***

Calendar	EARNINGS PER SHARE [A D] Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2017	1.45	.37	.21	1.58	3.62
2018	1.63	.44	.25	1.36	3.68
2019	1.77	.41	.10	1.67	3.94
2020	1.31	.68	***.20***	***1.66***	***3.85***
2021	***1.75***	***.60***	***.25***	***1.75***	***4.35***

Calendar	QUARTERLY DIVIDENDS PAID [B■†] Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2016	.405	.450	.450	.450	1.76
2017	.450	.495	.495	.495	1.94
2018	.495	.520	.520	.520	2.06
2019	.520	.545	.545	.545	2.16
2020	.545	.570			

BUSINESS: Southwest Gas Holdings, Inc. is the parent holding company of Southwest Gas and Centuri Group. Southwest Gas is a regulated gas distributor serving about 2.1 million customers in parts of Arizona, Nevada, and California. Centuri provides construction services. 2019 margin mix: residential and small commercial, 84%; large commercial and industrial, 3%; transportation, 13%. Total throughput: 2.3 billion therms. Has 8,944 employees. Off. & dir. own .8% of common stock; BlackRock, Inc., 13.5%; The Vanguard Group, Inc., 10.3%; T.Rowe Price Assoc., Inc., 6.8% (3/20 Proxy). Chairman: Michael J. Melarkey. Pres. & CEO: John P. Hester. Inc.: DE. Address: 5241 Spring Mountain Road, Las Vegas, Nevada 89193. Telephone: 702-876-7237. Internet: www.swgas.com.

Southwest Gas reported fairly solid results for the June quarter. The top line advanced approximately 6%, year over year, to $757.2 million. Business fundamentals remained fairly solid despite a challenging macroeconomic environment. The utility segment performed relatively well, while the infrastructure services line, Centuri, benefited as its customers continued to invest capital to enhance the safety and reliability of their delivery systems. Earnings per share clocked in at $0.68, a strong improvement from the prior-year tally. The bottom line benefited from a $12 million gain ($0.22 per share) due to increases in the cash surrender value of company-owned life insurance policies.

Performance ought to remain fairly solid in the coming quarters. Considerable economic weakness associated with restrictive social measures adopted to curb the spread of the coronavirus will likely still have some impact on the company's operations. Still, demand ought to remain relatively healthy for the essential services that Southwest Gas provides. Performance on the utility side should be supported by a growing customer base, infrastructure tracker mechanisms, expansion projects, and rate relief. The company currently has rate case proceedings ongoing for each of the three states it serves. These proceedings are expected to be resolved by the end of the year. Elsewhere, the infrastructure services operation will likely benefit from the increasing need for utilities to replace aging infrastructure, though this line may experience a measure of unevenness in the near term.

This stock is neutrally ranked for Timeliness. Looking further out, we anticipate greater revenues and earnings per share for the company over the pull to mid-decade. However, this appears to be partly discounted by the recent quotation, and the stock's appreciation potential is not particularly compelling. Moreover, the dividend yield is not especially attractive for a utility. A pullback in the stock price some time in the future may present conservative accounts with a more advantageous entry point. Southwest Gas earns good marks for Financial Strength, Price Stability, Growth Persistence, and Earnings Predictability.

Michael Napoli, CFA *August 28, 2020*

(A) Diluted earnings. Excl. nonrec. gains (losses): '05, (11¢); '06, 7¢. Next egs. report due early November. **(B)** Dividends historically paid early March, June, September, and December. ■† Div'd reinvestment and stock purchase plan avail. **(C)** In millions. **(D)** Totals may not sum due to rounding.

Company's Financial Strength	A
Stock's Price Stability	85
Price Growth Persistence	90
Earnings Predictability	95

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