

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF COLORADO**

PROCEEDING NO. 22AL-0348G

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IN THE MATTER OF ADVICE LETTER NO. 584 FILED BY ATMOS ENERGY CORPORATION TO REVISE ITS COLORADO P.U.C. NO. 7 TARIFF TO PLACE INTO EFFECT CHANGES TO THE COMPANY'S ANNUAL REVENUES AND RECOVERY OF RATE CASE EXPENSES, TO BECOME EFFECTIVE SEPTEMBER 5, 2022.

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**RECOMMENDED DECISION OF  
ADMINISTRATIVE LAW JUDGE  
CONOR F. FARLEY  
PERMANENTLY SUSPENDING TARIFF SHEETS,  
REQUIRING FILINGS, AND CLOSING PROCEEDING**

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Mailed Date: March 15, 2023

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**I. STATEMENT**

**A. Procedural Background**

1. On August 5, 2022, Atmos Energy Corporation (Atmos) filed Advice Letter No. 584 with tariff sheets for its base rate schedules for natural gas utility service to Colorado customers. Through Advice Letter No. 584, Atmos seeks a net annual increase in base rate revenue of approximately \$7.7 million, a recovery of an estimated \$750,000 of rate case expenses, and an extension of its System Safety and Integrity Rider (SSIR) for five additional years through 2028. The residential class would bear responsibility for all of the revenue increase, which would cause

residential annual bills to increase by approximately 8 to 9 percent. The effective date of the tariffs filed with Advice Letter No. 584 is September 5, 2022. With the Advice Letter, Atmos filed the direct testimony of Bart Armstrong, Dylan D'Ascendis, John Willis, Rob Leivo, Michelle Faulk, Dane Watson, Joe Christian, Gary Smith, and Paul Raab.

2. On August 17, 2022, Trial Staff of the Colorado Public Utilities Commission (Staff) filed a protest to Atmos' Advice Letter No. 584. In its protest, Staff specified several issues raised by Advice Letter No. 584 that it intends to examine in the proceeding. Staff also requested that the Commission consider requiring Atmos to file Supplemental Direct Testimony that provides Atmos' 10-year investment plans and resulting rate impacts.

3. On August 26, 2022, Atmos filed a response to Staff's request for supplemental direct testimony, arguing that it should be denied. Atmos explained its decision to file a historic test year for the purpose of minimizing controversy in this rate case by reducing the use of forecasts. Atmos also questioned the relevance of the suggested forecast to the setting of base rates in this Proceeding. Atmos further stated that it does not have capital investment forecasts beyond five years.

4. On August 15, 2022, the Colorado Office of the Utility Consumer Advocate (UCA) filed a protest to Atmos' Advice Letter No. 584 (UCA's Protest). Like Staff, UCA identified several issues that it intends to explore in this proceeding. UCA also argued that House Bill (HB) 21-1266 requires Atmos to address the impact of its proposed rates on income-qualified and disproportionately impacted (DI) communities and that Atmos failed to do so. UCA requested that the Commission direct Atmos to file supplemental direct testimony describing the outreach it conducted with such communities prior to submitting Advice Letter No. 584 (Request for Supplemental Direct Testimony).

5. On August 25, 2022, Atmos filed a response to this aspect of UCA's protest. Atmos stated that it welcomes the opportunity to collaborate with the Commission, the UCA, and other parties to aid the Commission in its compliance with HB 21-1266 and § 40-2-108(3)(b), C.R.S., in this adjudicatory proceeding. However, Atmos argued that contrary to UCA's argument, HB 21-1266 did not impose any requirements on utilities like Atmos to address the effect of its proposed rates, terms, and conditions on income-qualified and DI communities. Atmos concluded that it is inappropriate and inconsistent with the law to shift the Commission's responsibilities to Atmos or to impose pre- or post-filing requirements that do not exist.

6. UCA filed a Motion for Leave to Reply to Atmos' Response (Motion for Leave) on August 26, 2022. UCA questioned the propriety of Atmos' filing a response to a protest in light of the Commission's Rules of Practice and Procedure. More substantively, UCA repeated its argument that § 24-4-109, C.R.S., applies to this case and that Atmos' omission of this alleged legal requirement is a misstatement of law that merits a response.

7. By Decision No. C22-0514 issued September 1, 2022, the Commission set the tariff pages for hearing pursuant to § 40-6-111(1), C.R.S., which suspended their effective date through January 3, 2023, and referred this proceeding to an ALJ for disposition. The proceeding was subsequently assigned to the undersigned ALJ. Decision No. C22-0514 also set October 3, 2022, as the deadline for filing a pleading to intervene in this matter, and granted Staff's request to order Atmos to file Supplemental Direct Testimony addressing its ten-year investment plans and resulting rate impacts. Finally, Decision No. C22-0514 directed the undersigned ALJ to: (a) establish the deadline for the filing of the Supplemental Direct Testimony requested by Staff; (b) address UCA's Request for Supplemental Testimony addressing the impact of its proposed rates on income-qualified customers and DI communities; and (c) rule on UCA's Motion for Leave.

8. On September 30, 2022, the ALJ issued Decision No. R22-0592-I that denied UCA's Request for Supplemental Direct Testimony and Motion for Leave, scheduled a remote prehearing conference for October 14, 2022 at 9:00 a.m., required the parties to confer about a schedule for the proceeding and Atmos to file a report of conferral by October 11, 2022, and shortened the time to respond to any motions to intervene filed after September 29, 2022 to October 11, 2022.

9. Also on September 30, 2022, Energy Outreach Colorado (EOC) filed a Motion to Intervene.

10. On October 5, 2022, Atmos filed an Unopposed Motion to Reschedule the remote prehearing conference to October 20 or 21, 2022 due to scheduling conflicts.

11. On October 10, 2022, Atmos filed the Conferral Report required by Decision No. R22-0592-I and an Unopposed Motion to Approve Consensus Schedule and Vacate the Remote Prehearing Conference (Unopposed Motion).

12. On October 13, 2022, the ALJ issued Decision No. R22-0617-I that granted EOC's Motion to Intervene, granted the Unopposed Motion, and scheduled a remote hearing in this proceeding for January 5-6 and 9-11, 2023. Decision No. R22-0617-I also stated that one or more public comment hearings would be scheduled in a separate decision.

13. On October 17, 2022, Atmos filed the Supplemental Direct Testimony of Mr. Christian.

14. On November 16, 2022, Intervenors filed their Answer Testimony. Specifically, Staff filed the Answer Testimony of Nardos Ghebregziabher, Fiona Sigalla, Karl Kunzie, Eric Haglund, Luis Rivera Lugo, Adam Fuller, Marianne Ramos, and Adam Gribb; UCA filed the

Answer Testimony of Cory Sluzak, Ronald Fernandez, Dr. Scott England, and David Peterson; and EOC filed the Answer Testimony of Andrew Bennett.

15. On November 23, 2022, the ALJ issued Decision No. R22-0769-I that scheduled remote public comment hearings for December 8, 2022, and January 3, 2023, both from 11:30 a.m. to 1:30 p.m.

16. On December 8, 2022, and January 3, 2023, the public comment hearings took place.

17. On December 13, 2022, Atmos filed the Rebuttal Testimony of Messrs. Armstrong, Christian, D'Ascendis, Leivo, Raab, Smith, and Willis.

18. On January 5-6 and 9-10, 2023, the evidentiary hearing took place.

19. During the hearing, the following exhibits were entered into the evidentiary record: Hearing Exhibits 100 (and all of the exhibits and confidential exhibits listed therein); 112, Attach. JTC-7, Rev. 1; 117, Rev. 1; 119; 121-124; 126; 126, Attach. 1; 127; 130; 131; 132; 134; 309; 402, Rev. 1; 309; 404-406; 408-440; 443-446; 448; 449; 451; 454-457; 500, Rev. 2; 500, Attach. AB-12, Rev. 1; 503; 505-508; 513; 516; 521-523, and Confidential Hearing Exhibits 127C; and 508C.

20. On January 30, 2023, closing statements of position (SOPs) were filed by Atmos, Staff, UCA,<sup>1</sup> and EOC.

21. During the course of this proceeding, the Commission received 23 written comments from members of the public.

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<sup>1</sup> UCA filed a revised version of its SOP on February 2, 2023.

## **II. PUBLIC COMMENTS**

22. As noted above, the Commission received 23 written comments from members of the public. Each of the comments addressed one or more of three themes. First, the Commission should not approve any increase of rates because Atmos' bills are already too high. Second, Atmos earnings are unreasonably high and have significantly increased over the last year during which Atmos' customers' bills have significantly increased as well. Third, Atmos' commodity costs have also increased at a dramatic rate over the last year.

## **III. LEGAL PRINCIPLES AND BURDENS OF PROOF**

### **A. Commission Jurisdiction and the Rate Setting Process**

23. The Commission's authority to regulate Atmos' gas utility rates, services, and facilities derives from Article XXV of the Colorado Constitution. The Commission is charged with ensuring the provision of safe and reliable utility service at just and reasonable rates for customers pursuant to §§ 40-3-101, 40-3-102, 40-3-111, and 40-6-111, C.R.S.

24. Pursuant to § 40-3-101(1), C.R.S., “[a]ll charges made, demanded, or received by any public utility for any rate, fare, product, or commodity furnished or to be furnished or any service rendered or to be rendered shall be just and reasonable.” In interpreting that statute, the Colorado Supreme Court has held that the primary purpose of utility regulation is to ensure that the rates charged are not excessive or unjustly discriminatory.<sup>2</sup>

25. Further, § 40-3-102, C.R.S., states that “[t]he power and authority is hereby vested in the public utilities commission of the state of Colorado and it is hereby made its duty to adopt all necessary rates, charges, and regulations to govern and regulate all rates, charges, and tariffs of

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<sup>2</sup> *Cottrell v. City & County of Denver*, 636 P.2d 703 (Colo. 1981).

every public utility of this state to correct abuses; to prevent unjust discriminations and extortions in the rates, charges, and tariffs of such public utilities of this state.”

26. The decision to establish rates that will be charged by public utilities is a legislative function that has been delegated to the Commission.<sup>3</sup> The Commission must adopt rates and rate structures that are fair and reasonable.<sup>4</sup> Setting rates “is not an exact science but a legislative function involving many questions of judgment and discretion.”<sup>5</sup>

27. In setting rates, the Commission must consider the interests of both the utility’s investors and its consumers. Sound judgment in the balancing of their respective interests is how the ratemaking decision is reached rather than by use of a mathematical or legal formula.<sup>6</sup> Consequently, the Commission “may set rates based on the evidence as a whole” and “need not base its decision on specific empirical support in the form of a study or data.”<sup>7</sup> In setting rates, the Commission must balance “the investor’s interest in avoiding confiscation and the consumer’s interest in prevention of exorbitant rates,”<sup>8</sup> and set rates that “protect both: (1) the right of the public utility company and its investors to earn a return reasonably sufficient to maintain the utility’s financial integrity; and (2) the right of consumers to pay a rate which accurately reflects the cost of service rendered.”<sup>9</sup>

28. The Commission establishes rates to recover the utility’s revenue requirements using a test year selected by the Commission. The revenue requirement is the total revenues

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<sup>3</sup> *City and County of Denver v. Public Utilities Comm’n.*, 266 P.2d 1105, 1106 (1954).

<sup>4</sup> *Integrated Network Services, Inc. v. PUC*, 875 P.2d 1373, 1381 (Colo. 1994).

<sup>5</sup> *Id.*; see also *PUC v. Northwest Water Corporation*, 168 Colo. 154, 551 P.2d 266 (1963).

<sup>6</sup> *PUC v. Northwest Water Corp.*, 551 P.2d 266, 276 (1963).

<sup>7</sup> *Colorado Office of Consumer Counsel v. PUC*, 275 P.3d 656, 660 (Colo. 2012).

<sup>8</sup> *Colorado Municipal League v. PUC*, 687 P.2d 416, 418 (Colo. 1984).

<sup>9</sup> *Public Service Company of Colorado v. PUC*, 644 P.2d 933, 939 (Colo. 1982).

required by the utility to cover both its expenses and to have a fair or reasonable opportunity to earn a fair rate of return (ROR). While the utility has a reasonable opportunity to realize the ROR set by the Commission, the ROR is not guaranteed.

29. In an appeal from a Commission rate case decision, the Colorado Supreme Court “reiterated that ‘it is the result reached, not the method employed, which determines whether a rate is just and reasonable.’”<sup>10</sup> Moreover, the Colorado Supreme Court has consistently held that the doctrine of *stare decisis* does not apply to Commission decisions, and that the Commission’s prior decisions cannot be applied as binding precedent in future proceedings involving the same utility or to any other utility. The Commission’s decision in each new proceeding must be based upon new, substantial evidence in the record of the new case.<sup>11</sup> Consistent with this principle, the Colorado Supreme Court has noted that:

[s]ince rate setting is a legislative function which involves many questions of judgment and discretion, courts will not set aside the rate methodologies chosen by the [Commission] unless they are inherently unsound.

*CF&I Steel, L.P. v. Pub. Utils. Comm’n.*, 949 P.2d 577, 584 (Colo. 1997)[.] ...

Indeed,

the [Commission] is not bound by a previously utilized methodology when it has a reasonable basis, in the exercise of its legislative function, to adopt a different one.

*CF&I Steel*, 949 P.2d at 584.<sup>12</sup>

## **B. Derivation of the Revenue Requirement**

30. The revenue requirement formula is:

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<sup>10</sup> *Glustrom v. PUC*, 280 P.3d 662, 669 (Colo. 2012), (quoting *Colorado Ute Electric Association, Inc. v. PUC*, 198 Colo. 534, 602 P.2d 861, 864 (Colo. 1979) (citing *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944))).

<sup>11</sup> See *Colorado Office of Consumer Counsel v. Public Service Company*, 877 P.2d 867, 876 (Colo. 1994); *Colorado-Ute*, 602 P.2d at 865; *B&M Services, Inc. v. PUC*, 429 P.2d 293, 295 (Colo. 1967).

<sup>12</sup> *Glustrom*, 280 P.3d at 669.

$$\text{Revenue requirement} = E + r(\text{RB})$$

WHERE:	E	=	Expenses = O + D + T
	O	=	Operating expenses, including wages and salaries, administrative expenses, taxes other than income taxes, fuel costs, and various maintenance expenses
	D	=	Annual depreciation expenses
	T	=	Income taxes (state and federal)
	r	=	Rate of return (return on bonds, preferred stock, and common stock (equity))
	RB	=	Rate base = v - d
	v	=	(1) Plant in service plus: (2) Working capital (cash working capital + materials and supplies)
	d	=	Accumulated depreciation and accumulated deferred income taxes

31. In past rate cases and as discussed below, the Commission has established regulatory principles and methods to use to determine a utility’s revenue requirement.

**C. Test Year**

32. The rate setting process begins with the selection of a test year that is used to evaluate and to adjust (as necessary) the interrelationships of a utility’s revenue, expense, and capital investment to determine whether the utility has a revenue excess or deficiency. These components should correspond to each other over the same time period or according to the same operating conditions. This is known as the “matching principle”, and it is designed to ensure “that the cost of service reflects the operational relationships and interplay between rate base,

expenses, and revenues in a manner that is representative of the period when the resulting rates will be in effect.”<sup>13</sup>

33. It is the interaction of the component parts of a test year and how they are affected by a utility’s operations that is important for purposes of rate setting. Obviously, the absolute quantities of these components will change when the test year has ended, and the new rate year arrives. Accordingly, the key to test year integrity is to make the interrelationship of revenue, expense, and capital investment as representative of future operations as possible.

34. A utility’s revenue requirement is determined from the revenues, expenses, and rate base from an identified period, which is known as a test year. The parties in this proceeding agree on using a historic test year (HTY) from March 1, 2021, to March 31, 2022.

#### **D. Burden of Proof and Burden of Going Forward**

35. Except as otherwise provided by statute, the Administrative Procedure Act imposes the burden of proof in administrative adjudicatory proceedings upon “the proponent of an order.”<sup>14</sup> The party bearing the burden must prove its case by a preponderance of the evidence.<sup>15</sup> The evidence must be “substantial evidence,” which is defined as “such relevant evidence as a reasonable mind might accept as adequate to support a conclusion ... it must be enough to justify, if the trial were to a jury, a refusal to direct a verdict when the conclusion sought to be drawn from it is one of fact for the jury.”<sup>16</sup> This standard requires that evidence of the existence of a contested

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<sup>13</sup> Decision No. C11-1373 issued in Proceeding No. 11AL-382E on December 22, 2011 at 20 (¶ 51).

<sup>14</sup> § 24-4-105(7), C.R.S.

<sup>15</sup> § 24-4-105(7), C.R.S.; § 13-25-127(1), C.R.S.; Rule 1500 of the Rules of Practice and Procedure, 4 *Code of Colorado Regulations* 723-1.

<sup>16</sup> See, e.g., *City of Boulder v. Pub. Utils. Comm’n*, 996 P.2d 1270, 1278 (Colo. 2000) (quoting *CF&I Steel, L.P. v. Pub. Utils. Comm’n*, 949 P.2d 577, 585 (Colo. 1997)).

fact outweighs the evidence to the contrary.<sup>17</sup> That is, the finder of fact must find that the existence of a contested fact is more probable than its non-existence for a party to carry its burden.<sup>18</sup>

### **E. Analytical Approach**

36. In rendering this Decision, the ALJ has carefully reviewed and considered all the evidence introduced by the Parties during the hearing, including the testimony and hearing exhibits, even if this Decision does not specifically address all of the evidence presented, or every nuance of each party's position in each issue. Moreover, the ALJ has considered all the legal arguments set forth in the SOPs, even if the Decision does not explicitly address every legal argument. In rendering this Decision, the ALJ has weighed the evidence and evaluated the credibility of all the witnesses and hearing exhibits.<sup>19</sup>

## **IV. SSIR**

37. The SSIR was established in Atmos' 2015 rate case to replace bare steel and PVC pipe. The SSIR was extended for five years in the Company's 2017 rate case and currently includes replacement of bare steel and PVC, as well as the GIS improvement project, which is anticipated to be completed in 2023. The Stipulation and Settlement Agreement in the 2015 rate case stated that "[a]ll projects that replace bare steel or [PVC] will be classified as high-risk projects without a quantitative risk assessment."<sup>20</sup> "Bare steel and PVC pipes deteriorate with age and are prone to leaks and potential failure, which impacts both safety and reliability of the pipeline system, as well as increasing greenhouse gas emissions."<sup>21</sup>

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<sup>17</sup> *Mile High Cab, Inc. v. Colorado Public Utilities Comm'n.*, 302 P.3d 241, 246 (Colo. 2013).

<sup>18</sup> *Swain v. Colorado Department of Revenue*, 717 P.2d 507 (Colo. App. 1985).

<sup>19</sup> See *Durango Transportation, Inc. v. Colorado Public Utilities Comm'n.*, 122 P.3d 244, 252 (Colo. 2005); *RAM Broadcasting of Colo., Inc. v. Public Utilities Comm'n.*, 702 P.2d 746, 750 (Colo. 1985).

<sup>20</sup> Stipulation and Settlement Agreement filed in Proceeding No. 15AL-0299G on September 23, 2015 at 21.

<sup>21</sup> Hearing Exhibit 104 at 5:12-14 (Direct Testimony of Mr. Willis).

38. The record in this proceeding reflects that there are 439 miles of bare steel and PVC pipe remaining in Atmos' system to be replaced. As of the end of the 2021 SSIR program year, Atmos had replaced 62.6 miles of bare steel service main, 4,164 bare steel service lines, and three miles of PVC pipe.<sup>22</sup> As a result, there are 193 miles of bare steel pipe and 245 miles of PVC pipes remaining to be replaced.<sup>23</sup> All of the bare steel and PVC pipe in Atmos' system was installed before Atmos acquired Greeley Gas Company in 1993.<sup>24</sup>

**A. Atmos**

39. Atmos contends that it would take 74 years to replace all of the remaining bare steel and PVC pipe at the pre-SSIR pace.<sup>25</sup> However, if the SSIR is continued at the current pace, Atmos estimates that all such pipe will be replaced by 2036.<sup>26</sup> The reason for the time disparity is because the replacement of bare steel and PVC is done for safety reasons, not growth. As a result, there is no new revenue to finance the replacement. Atmos would thus “need to reduce the pace of investment and/or file annual rate cases.”<sup>27</sup>

40. Atmos further contends that “[r]eplacing this pipe is critical because of the known and documented risks of bare steel and PVC.” As support, Atmos cites the statement in Decision No. C18-0311 that “[f]ailure of bare steel and PVC pipeline, if not repaired or replaced expediently, could likely lead to catastrophic events such as fires, explosions, serious property damage, and loss of life.”<sup>28</sup> Atmos argues that the SSIR is the best way to replace the problematic pipe because of

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<sup>22</sup> *Id.* at 13:16-19, 16:12-15.

<sup>23</sup> *Id.* at 8:14-16, 9:2-4.

<sup>24</sup> *Id.* at 8:11-13, 8:22-9:2.

<sup>25</sup> Atmos' SOP at 3 (citing Hearing Exhibit 306 at 19 (Answer Testimony of Ms. Ramos)).

<sup>26</sup> Hearing Exhibit 104 at 17:7-9 (Direct Testimony of Mr. Willis).

<sup>27</sup> Atmos' SOP at 4.

<sup>28</sup> *Id.* at 4 (citing Decision No. C18-0311 issued in Proceeding No. 17AL-0429G on May 3, 2018, at 7-8 (¶ 20)).

its transparency, prudence reviews, reduction in rate cases, and ability of Atmos to plan ahead and retain contractors to perform the work at the best possible prices.

41. Atmos requests a five-year extension of the SSIR. According to Atmos, the request satisfies the following four-part test identified by UCA: (a) the costs to be recovered constitute a significant portion of the utility's total expenditures; (2) the expenditures are beyond the utility's control; (3) the expenditures are increasing at a rate in excess of the general rate of inflation; and (4) the expenditures are volatile.<sup>29</sup> Atmos states that a five-year extension is appropriate because it originally proposed the SSIR to be in place for ten years, additional miles of bare steel and PVC pipe have been identified since approval of the SSIR, the extension would support the replacement of an additional 83 miles of high-risk bare steel and PVC pipe, and five years will "bridge the gap" to 2028 when Atmos will file its "first fully litigated Gas Infrastructure Plan."<sup>30</sup> Finally, the Commission's decision to terminate the Public Safety Integrity Adjustment (PSIA) of Public Service Company of Colorado (Public Service) does not support the termination of the SSIR because Atmos "has about 17 times more bare steel than other Colorado utilities" and Public Service had replaced all of the bare steel pipe in its system before the termination of the PSIA.<sup>31</sup>

42. Atmos also proposes to amend the SSIR tariff to make clear that "the true-up mechanism will continue to operate even if the Company is no longer able to propose or recover new SSIR Projects through the rider."<sup>32</sup>

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<sup>29</sup> Hearing Exhibit 306 at 13:15-14:4 (Answer Testimony of Ms. Ramos).

<sup>30</sup> Atmos SOP at 5-6. See also Hearing Exhibit 104 at 12 ("[M]ore miles of bare steel and PVC pipe were identified through the Company's GIS initiative."); Hearing Exhibit 101 at 16.

<sup>31</sup> *Id.* at 6. See also Hearing Transcript at 250:1-4 (January 5, 2023).

<sup>32</sup> Hearing Exhibit 117:16-18 (Rebuttal Testimony of Mr. Willis).

**B. Intervenors****1. Staff**

43. Staff advocates for the end of the SSIR. According to Staff, the SSIR was not intended to remain in place until Atmos completed all safety projects. Instead,

the SSIR was implemented as a temporary bridge mechanism to allow [Atmos] time to jump start its pipeline replacement plan and prioritize high-risk projects. This provided an opportunity for [Atmos] to adjust to a fundamental change of direction in pipeline safety mandates. Eight years is ample time for a jump-start.<sup>33</sup>

Staff notes that Atmos will complete all bare steel and PVC projects with the highest risk score of 4 or 5 by the end of 2023, which is when the SSIR is scheduled to expire.<sup>34</sup> For these reasons, and because riders like the SSIR raise questions regarding single-issue ratemaking, Staff suggests that Atmos should return to addressing safety and integrity investments in the ordinary course of business and recover the costs thereof through more regular advice letter filings.<sup>35</sup>

44. Even though it is proposing to terminate the SSIR, Staff also recommends that the Commission require the Company to: (a) maintain the same level of reporting on system safety and integrity projects and investments for the ten years after the SSIR expires; and (b) create a deferral account (SSIR Deferral) for all SSIR costs incurred after the SSIR expires. Staff contends it is in the public interest for Atmos to continue providing the same level of reporting regarding system safety projects after the end of the SSIR because of the transparency it provides. Staff's SSIR deferral proposal would require Atmos to track the depreciation expense associated with any new SSIR capital investments placed in service from January 1, 2023, to December 31, 2023, and

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<sup>33</sup> Hearing Exhibit 307 at 54:17-55:3 (Answer Testimony of Mr. Fuller).

<sup>34</sup> *Id.* at 56:3-6.

<sup>35</sup> Staff's SOP at 22-25.

defer these expenses for review and recovery in a future Phase I rate case. The capital expenditures included in the SSIR Deferral would be capped at the amount proposed by Atmos for SSIR projects to be completed in 2023. Staff proposes to allow Atmos to earn a return on any costs included in the SSIR Deferral at the weighted average cost of capital (WACC).<sup>36</sup>

45. Nevertheless, “Staff does recognize that Atmos still has significant pipeline replacement work to complete.”<sup>37</sup> For this reason, if the Commission decides to extend the SSIR, Staff recommends a two-year extension. Such an extension “would allow Atmos the ten years of accelerated cost recovery that the SSIR was originally proposed for.”<sup>38</sup> The extension should be on the same terms as currently exist, namely with the 2.5 percent cap on bill impacts and the costs in the SSIR would earn at the WACC.<sup>39</sup> Staff further proposes that Atmos be required to provide: (a) a plan for how the SSIR will be terminated in the future; (b) a thorough analysis of all projects to be included in an ongoing SSIR; (c) criteria used to determine whether future projects qualify for SSIR treatment; (d) a timeline for all SSIR projects to be completed, including a quantitative risk assessment; (e) a timeline for when all known piping made of unprotected bare steel, protected bare steel and PVC in the Atmos territory will be replaced; and (f) a plan stating how remaining projects in the SSIR and other future pipeline replacements or significant safety expenditures will be addressed through the ordinary course of business when the SSIR is terminated.

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<sup>36</sup> *Id.* at 25-26. *See also* Hearing Exhibit 307 at 58:13-60:6 (Answer Testimony of Mr. Fuller) (citing Hearing Exhibit 104, Confidential Attach. JMW-4C (Direct Testimony of Mr. Willis)).

<sup>37</sup> *Id.* at 25.

<sup>38</sup> *Id.*

<sup>39</sup> Hearing Exhibit 307 at 61:11-18 (Answer Testimony of Mr. Fuller).

## 2. UCA

46. UCA also recommends a two-year extension of the SSIR, which would operate as a wind-down of the program. Like Staff, UCA notes that when the SSIR was instituted, Atmos projected that it would take ten years to replace its problematic pipe. Upon expiration of a two-year extension, the SSIR will have been in place for ten years, thus matching Atmos' original prediction for the duration of the SSIR.<sup>40</sup>

47. UCA also argues that the two-year extension should be limited to high-risk projects.<sup>41</sup> UCA contends that the "original intent" of the SSIR was to focus exclusively on high-risk projects, but that Atmos has included medium-risk projects in the program. UCA also argues that Atmos' return on the SSIR investments should be at the weighted average cost of long-term debt, which is consistent with the Commission's recent decision approving an SSIR for Black Hills Colorado Gas, Inc. A return at the weighted average cost of long-term debt, rather than at the WACC, achieves a fairer risk-reward balance for Atmos. The SSIR benefits Atmos by reducing regulatory lag, the risk of disallowances, and Atmos' safety and liability risks. Given these inherent benefits of the SSIR enjoyed by Atmos, it is fairer for Atmos to receive a return at its weighted average cost of long-term debt.<sup>42</sup>

## 3. EOC

48. EOC is generally supportive of Staff's recommendations regarding the SSIR.<sup>43</sup>

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<sup>40</sup> UCA's SOP at 10-13.

<sup>41</sup> Hearing Exhibit 400, Rev. 1 at 39:19-40:13 (Answer Testimony of Mr. Skluzak).

<sup>42</sup> *Id.* at 36:17-39:18.

<sup>43</sup> EOC's SOP at 4.

**C. Analysis**

49. The ALJ finds and concludes that it is in the public interest for the SSIR to continue for two more years beyond its current termination date and that Atmos' return on its SSIR investments during the two-year extension period should be at its weighted average cost of debt. As noted, when first proposed, Atmos stated that the SSIR would need to be in place for ten years. Atmos thus believed that it could sufficiently address the problematic pipe in its system during that ten-year period. A two-year extension with a goal of terminating the SSIR at the end of the extension will hold Atmos to its original representations, recognize that contemporary recovery of investment should be reserved for extraordinary circumstances and incentivize utilities that enjoy SSIR-type of program to work with alacrity to address the extraordinary circumstances that justified the contemporary recovery program in the first place.

50. The ALJ is not going to order Atmos to focus exclusively on projects it categorizes as high-risk. There is not a sufficient record upon which to base such a decision that, consequently, could lead to unintended consequences. For example, it could be that a medium or low-risk project must be completed before a high-risk can be addressed. As a result, the ALJ will not so limit Atmos' discretion in managing the SSIR. That being said, it is the ALJ's expectation that all high-risk projects will be completed within this two-year extension.

51. The ALJ finds and concludes that it is in the public interest for Atmos to earn at the weighted average cost of long-term debt for SSIR costs incurred during the extension. The UCA is correct that the SSIR benefits Atmos by reducing regulatory lag and the risk of disallowances, which decreases Atmos' risk of not recovering costs. Atmos has enjoyed, and will continue to enjoy, a WACC return on costs incurred during the current phase of the SSIR. However, the ALJ finds and concludes that limiting Atmos to a return at the weighted average cost of long-term debt

on costs incurred during the extension period will fairly balance the interests of ratepayers and shareholders and will yield just and reasonable rates.

**V. PHASE I ISSUES**

**A. Test Year**

52. As noted above, the parties agree that Atmos' revenue requirement should be determined using an HTY from March 1, 2021, to March 31, 2022.

**B. Rate Base**

53. Rate base is the value of the utility's investor-supplied plant facilities and other investments required in providing utility service to customers on which a utility is allowed a reasonable opportunity to earn a fair rate of return. There are generally two common methods of calculating rate base: (a) average-year or thirteen-month average; and (b) year-end. The year-end method of calculating rate base uses the value of the plant assets as they exist at year-end. In contrast, average-year rate base is computed by calculating the average of thirteen consecutive month-end balances.

**1. Year-End or Thirteen-Month Average**

**a. Atmos**

54. Atmos' proposed rate base includes plant in service, accumulated depreciation and amortization, construction work in progress (CWIP), gas stored underground, accumulated deferred income tax (ADIT), customer deposits, customer advances, prepayments, cash working capital, excess deferred income taxes, and cloud projects. The Company is proposing to use a year-end rate base method for its HTY ending March 31, 2022, for net plant in service, CWIP, and

ADIT.<sup>44</sup> Atmos further proposes to use a thirteen-month average calculation for gas stored underground, customer deposits, and customer advances for construction,<sup>45</sup> which Staff contends accounts for three percent of Atmos' rate base.<sup>46</sup>

55. Atmos Energy claims that using its year-end method to calculate virtually all of its rate base will allow it a reasonable opportunity to earn a "fair" return on rate base going forward. According to Atmos, it has not been earning a fair return because: (a) it is experiencing earnings attrition as a result of significant ongoing capital investments above and beyond SSIR investment; and (b) its capital investments will not produce offsetting revenue increases based on an average period rate base methodology. Atmos expects the use of year-end plant will help incorporate more of the ongoing capital investment in the rates determined in this case, thus reducing the amount of regulatory lag and attrition in rate of return.<sup>47</sup>

#### **b. Intervenors**

56. Staff and UCA argue for use of the average-year method of calculating rate base. According to Staff and UCA, because plant is added and removed throughout the test year, using the year-end method provides an unrepresentative picture of the level of rate base during the test year because it is a snapshot taken at a single point of time. According to Staff and UCA, using a 13-month average smooths out these peaks and troughs in a utility's plant facilities and provides a more accurate representation of rate base during the test year. Staff also asserts that the average-year method generally better reflects the relationship between test year investments, revenues, and expenses. Finally, Staff and UCA assert that the Commission has used a 13-month

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<sup>44</sup> Hearing Exhibit 102 at 21:12-14 (Direct Testimony of Mr. Christian).

<sup>45</sup> *Id.* at 25:16-17.

<sup>46</sup> Hearing Exhibit 300, Rev. 1 at 46:9-47:4 (Answer Testimony of Ms. Ghebregziaber).

<sup>47</sup> Hearing Exhibit 102 at 23:9-24:10 (Direct Testimony of Mr. Christian).

average in recent Phase I proceedings, but has been willing to use the year-end approach where a utility has suffered earnings attrition beyond its control.

57. While Staff and UCA concede that Atmos has suffered some attrition, they argue that the use of the year-end calculation of rate base is unjustified. Staff asserts that Atmos' recent attrition is not unusual in magnitude since at least 2012 and Atmos has not filed frequent rate cases during that period due to attrition.<sup>48</sup> UCA argues that Atmos has not explained its unusually large attrition in March 2022, which UCA suggests may be the result of "Atmos 'creating' a large negative amount for its rate filing."<sup>49</sup>

58. Staff and UCA further agree that any attrition suffered by Atmos has not been beyond its control. The SSIR has provided Atmos with a near contemporaneous recovery of most of its investments plus a return at the weighted average cost of capital. Staff concedes that Atmos has increased its level of non-SSIR system integrity projects, but asserts that Atmos' attrition must be a function of its pace of investment in such projects, over which Atmos has control.

### **c. Analysis**

59. In choosing between year-end or 13-month average for determining rate base, the Commission has stated:

In previous decisions, the Commission has stated that in most cases average rate base more accurately reflects the relationship between test year investments, revenues, and expenses than a year-end rate base. However, the Commission also has acknowledged in prior decisions that the use of year-end rate base may be proper in special circumstances, for example, to combat some potential sources of attrition beyond control of the Company, such as growth in plant, especially plant that is non-revenue producing[.]<sup>50</sup>

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<sup>48</sup> Hearing Exhibit 300, Rev. 1 at 57:8-59:10 (Answer Testimony of Ms. Ghebreghziaber).

<sup>49</sup> HE 400, Rev. 1 at 45: 6-9 (Answer Testimony of Mr. Skluzak).

<sup>50</sup> Decision No. C93-1346 issued in Proceeding No. 93S-001EG on October 27, 1993 at 39.

Elsewhere, the Commission has pointed to the existence of inflation and capital growth beyond the control of the utility as potential additional justifications for using the year-end method of calculating rate base.<sup>51</sup> The undersigned ALJ concludes that the standard enunciated above is well-reasoned and persuasive and shall be followed in this proceeding.

60. The ALJ further finds and concludes that Atmos has not satisfied its burden of establishing that any of the circumstances exist justifying the use of the year-end methodology for calculating rate base. As to inflation, Atmos does not rely on it as a basis for its attrition argument. In addition, as noted above, a significant portion of Atmos's pipeline integrity investments has enjoyed current recovery on a dollar-for-dollar basis through the SSIR. And, as to non-SSIR growth, the record does not establish that Atmos does not have control over that spending.<sup>52</sup> Finally, the Commission has noted that "investors realistically can expect a certain amount of attrition," particularly as a consequence of significant capital spending.<sup>53</sup> Accordingly, Atmos has not established any "special" or "extraordinary" circumstances justifying the use of the year-end methodology. A thirteen-month average rate base shall be used in this proceeding.

## **2. Underground Gas Storage**

### **a. Atmos**

61. Atmos requests that the average balance of gas it stores underground be included in rate base, which would allow Atmos to earn its WACC on such inventories. Atmos says that including gas stored underground is a "ratemaking convention" because multiple Commission

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<sup>51</sup> Decision No. 85724 issued in Docket No. 868 on September 24, 1974, at 11.

<sup>52</sup> See Hearing Exhibit 300, Rev. 1 at 59:1-10 (Ms. Ghebreziaoabher's Answer testimony); Hearing Exhibit 400, Rev. 1 at 44:4-45:13 (Mr. Skluzak's Answer Testimony).

<sup>53</sup> See Decision No. C81-1999 issued in Investigation and Suspension Docket No. 1525 on December 1, 1981 at 77-78.

decisions have approved it. Further, because ratepayers pay for gas when it is consumed, allowing Atmos to earn a WACC return on the average balance in storage would “allow the Company a reasonable opportunity to recover the costs of carrying those balances.”<sup>54</sup>

62. Atmos includes a \$6.1 million adjustment to the value of the gas stored underground by repricing it “at a level representative of the upcoming 2022-2023 winter.”<sup>55</sup> Specifically, Atmos proposes to reprice “[t]he test period injections (April 2021-October 2021) and withdrawals (November 2021-March 2022) . . . using current market information.”<sup>56</sup> Atmos contends this is a known and measurable adjustment that is necessary:

because the commodity price of natural gas has increased significantly over the past several months. The test period weighted average cost of gas stored underground in October 2021 was \$3.24 as compared to the anticipated weighed average cost of gas stored underground going into the upcoming winter of \$6.45. Without this adjustment the Company will be unable to have a reasonable opportunity to earn its authorized rate of return.<sup>57</sup>

According to Atmos, its “forecasted costs available when direct testimony was filed proved to be conservative, compared to the actual balance of gas stored underground as of October 2022” because “[a]s of October 2022, the gas stored underground balance was \$18.2 million, which is an increase of \$8.4 million, compared to Company’s upward adjustment of \$6.1 million” in its direct testimony filed on August 5, 2022.<sup>58</sup>

63. Atmos further argues that the underground stored gas should not be recovered through the Gas Cost Adjustment (GCA) and earn at the cost of short-term debt, as urged by Staff and UCA. Atmos contends that, if adopted, the proposal would “encourage [Atmos] to reduce

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<sup>54</sup> Atmos’ SOP at 16.

<sup>55</sup> Hearing Exhibit 102 at 27:8-11 (Direct Testimony of Mr. Christian).

<sup>56</sup> *Id.* at 27:11-14.

<sup>57</sup> *Id.* at 27:17-23.

<sup>58</sup> Atmos’ SOP at 16 & no. 75.

storage balances, which is contrary to public policy and could negatively impact price stability.”<sup>59</sup> Atmos also states that it “finances stored gas through retained earnings (i.e., equity) and short-term debt in the same way it finances pipe in the ground; therefore, its shareholders are entitled to a return on their investment” at the WACC rate.<sup>60</sup> Atmos asserts that recovering gas storage costs through the GCA would be inconsistent with the Uniform System of Accounts (USoA) accounting rules that apply to electric and gas utilities. As support, Atmos cites “USoA instructions that draw a nexus between gas storage costs and the calculation of rate base.”<sup>61</sup>

64. Finally, Atmos states that if gas storage is recovered through the GCA, ratepayers should pay for storage gas when it is injected, rather than when it is consumed, “to remove the disincentive for the Company to invest in storage and to better reflect the timing of the cost incurred to serve customers.”<sup>62</sup> Additionally, if the return on gas storage is limited to the cost of short-term debt, “then Atmos Energy should recover actual debt costs, including short-term debt facility costs, instead of an index rate,” as proposed by Staff and UCA.<sup>63</sup>

## **b. Intervenors**

### **(1) Staff**

65. Staff argues that gas storage costs should be recovered through the GCA “just like all other gas costs are recovered,” and Atmos should only be allowed to earn a return at its cost of short-term debt.<sup>64</sup> As support, Staff emphasizes that stored gas “is typically purchased and used

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<sup>59</sup> *Id.* at 16.

<sup>60</sup> *Id.* at 17.

<sup>61</sup> *Id.* (citing Hearing Exhibit 112 at 45 (Rebuttal Testimony of Mr. Christian)).

<sup>62</sup> *Id.* at 18.

<sup>63</sup> *Id.*

<sup>64</sup> Staff’s SOP at 16.

within a short time, a calendar year at most, and does not have the lifespan of most utility assets. It is by its nature a short-term asset, and the return earned by the Company should reflect that nature.”<sup>65</sup> Staff also points to the Commission’s decision approving Public Service’s return on its stored gas “at the cost of short-term debt, not at the WACC, given the temporary and volatile nature of the asset.”<sup>66</sup>

66. Staff opposes Atmos’ proposed repricing of the gas stored underground during the test year. According to Staff, a known and measurable adjustment is “verifiable on the record and certain of happening.”<sup>67</sup> Atmos’ proposal is inappropriate for two reasons. First, “[a] forecast of the future price of natural gas, by definition, cannot be known for certain to actually have occurred.”<sup>68</sup> Second, Atmos does not propose a “mechanism . . . to adjust the revenue requirement if or when the value of the gas storage underground decreases, thereby leaving customers paying too much for that item and the Company benefiting from the regulatory lag.”<sup>69</sup>

67. Staff disagrees that recovery of the costs of stored gas through the GCA is inconsistent with the USoA, stating:

The USoA prescribes the procedures for accounting for electric and natural gas utilities. The USoA does not prescribe what accounts should be included or not included in rate base. In fact, nowhere in that document does the USoA address rate base items. Nor do the words “rate base” or even “rate case” appear. Therefore, no alleged potential violation of USoA accounting rules can occur.<sup>70</sup>

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<sup>65</sup> *Id.*

<sup>66</sup> *Id.* at 17 (quoting Decision No. C22-0642 issued in Proceeding No. 22AL-0046G on October 25, 2022, at 112 (¶ 381)).

<sup>67</sup> Staff’s SOP at 17.

<sup>68</sup> *Id.*

<sup>69</sup> *Id.*

<sup>70</sup> *Id.* at 19.

68. Staff concludes that because stored gas is a short-term asset, it should be financed with short-term debt that “has a lower rate associated with it because it is less risky,” and Atmos should only be able to earn on that short-term asset at the lower cost of short-term debt. To determine the cost of short-term debt applicable to stored gas, Staff proposes to use “the average daily rates for Commercial Paper, Financial, 3-Month rates, published by the United States Federal Reserve Board H.15 report.”<sup>71</sup>

## (2) UCA

69. UCA agrees with Staff that: (a) Atmos’ proposed known and measurable adjustment to the value of its stored gas should be rejected; (b) Atmos’ stored gas should be recovered through the GCA; and (c) Atmos should earn on the asset at the rate of short-term debt, not the WACC. As support, UCA reiterates the points made by Staff. In addition, UCA notes that Atmos “accounts for Stored Gas, or Gas Stored Underground, as a ‘Current Asset.’”<sup>72</sup> This confirms that stored gas is short-term/temporary that is best addressed with short-term debt and not the WACC.

### c. Analysis

70. The ALJ finds and concludes that Atmos’ stored gas should be recovered through the GCA and Atmos should earn a return thereon at the cost of short-term debt. Staff and UCA have established that the value of stored gas is temporary and volatile. The Commission’s statement in Decision No. C22-0804 applies equally here: the dollar value of stored gas “fluctuates primarily on gas commodity costs and any given value of the asset is thus temporary and thus best addressed by short-term debt as argued by Staff. Moreover, a key feature of ratemaking for gas

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<sup>71</sup> Hearing Exhibit 302 at 17:12-14 (Answer Testimony of Mr. Kunzie).

<sup>72</sup> UCA’s SOP at 18 (citing Hearing Transcript at 69:7-21 (January 6, 2023) and Hearing Exhibit 446 at 38 (Atmos’ most recent SEC Form 10-K showing that Atmos accounts for stored gas as a current asset)).

utilities in Colorado is that they earn no return on gas commodity costs.”<sup>73</sup> Accordingly, it is just and reasonable and in the public interest for Atmos to recover its stored gas costs through the GCA and earn a return at the cost of short-term debt.

### **3. SSIR Investment**

#### **a. Atmos**

71. Atmos proposes to incorporate the SSIR investment through 2022 into rate base. Atmos contends that doing so is more efficient than not rolling in this investment at this time. Atmos recognizes that the SSIR spending in 2022 has not gone through the prudence review process and thus it could be seen as premature to roll in the 2022 spending at this time. However, Atmos argues that:

[t]here is no history of disallowances for SSIR investments and these SSIR investments either have been or will be vetted through the existing SSIR annual prudence review and true-up as required by the tariff. If any of the 2022 SSIR investments are disallowed through the prudence review process, the Company will make a corresponding negative adjustment to its subsequent SSIR recovery.<sup>74</sup>

#### **b. Intervenors**

##### **(1) Staff**

72. Staff states that “[a] request to roll rider projects into base rates is common at the Commission and is typically allowed.”<sup>75</sup> Such rider projects typically go through a prudence review process to determine whether the projects were prudently undertaken and administered in a prudent manner, thus resulting in costs for which ratepayers should appropriately pay. For this

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<sup>73</sup> Decision No. C22-0804 issued in Proceeding No. 22AL-0046G on December 13, 2022 at 30 (¶ 92).

<sup>74</sup> Atmos’ SOP at 8.

<sup>75</sup> Staff’s SOP at 15.

reason, “Staff does not object to putting 2021 projects the costs of which were being recovered through the SSIR into base rates. Those costs have been properly vetted” and deemed to be prudent.<sup>76</sup>

73. Projects undertaken in 2022 pursuant to the SSIR, however, have not been so vetted. If the SSIR is continued, Staff states that “2022 project costs deemed prudent [should] be recovered through the SSIR until Atmos’ next rate proceeding when they would typically be rolled into base rates.”<sup>77</sup> Staff’s bottom line is that “2022 costs should not be recovered through base rates since they have not been vetted for prudence.”<sup>78</sup>

## (2) UCA

74. As noted above, UCA advocates for a two-year extension of the SSIR. UCA does not take an express position on Atmos’ request to roll into rate base SSIR investment through 2022.

## (3) EOC

75. EOC is generally supportive of Staff’s recommendations regarding the SSIR.<sup>79</sup>

## 4. Analysis

76. The ALJ finds and concludes that it is appropriate to roll into rate base SSIR investment through 2021. As noted by Staff, the record in this proceeding does not reflect the result of the prudence review of the 2022 SSIR expenditures. As a result, it would be inappropriate to roll into rate base those 2022 expenditures.

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<sup>76</sup> *Id.*

<sup>77</sup> *Id.* at 16.

<sup>78</sup> *Id.*

<sup>79</sup> EOC’s SOP at 4.

### C. Weather Normalization

77. Proposed rates are developed based on the volume of gas consumed during the test-year. As a result, it is important to determine whether the weather during the test year was “normal.” If test year weather conditions deviate from normal, it is necessary to make adjustments to recognize what volumes would have been if condition were normal. To determine whether the weather in the test-year was normal, the number of “Heating Degree Days” (HDDs) are determined for a certain period and then compared to the HDDs during the test-year.

#### 1. Atmos

78. In its direct testimony, Atmos defined normal weather as the average of the thirty-years from 1981 to 2010. In its rebuttal testimony, Atmos accepted Staff’s recommendation to define normal weather as the average of the ten years ending March 31, 2022. Colorado’s climate has warmed in recent decades. As a result, more recent years better reflect the current and future “normal” weather than years in the more distant past. Atmos accepted Staff’s assertion that “defining normal weather using average temperatures over the most recent 10-year period is likely to be a more accurate reflection of current and future temperatures.”<sup>80</sup>

79. Atmos also performed a regression analysis to understand the correlation between heating degree days and natural gas consumption. Specifically, Atmos calculated fourteen separate regression analyses for its Residential customers and its Commercial customers and included 72 months of data in each regression. According to Atmos, this methodology matches the

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<sup>80</sup> Hearing Exhibit 116 at 4:16-18 (quoting Hearing Exhibit 303 at 20:17-2 (Answer Testimony of Mr. Haglund).

calculations approved in Proceeding No. 17AL-0429G and thus makes the test-year reflect the most accurate weather-normal year.<sup>81</sup>

## **2. Intervenors**

### **a. Staff**

80. As noted above, Staff recommends using a 10-year period ending March 31, 2022, to calculate the normal HDDs, which, as noted above, Atmos accepted in its rebuttal testimony.

### **b. UCA**

81. UCA recommends using the 30-year period from 1981-2010 to define the normal HDDs.<sup>82</sup> UCA further rejects Atmos' regression analysis because it is "an attempt to deemphasize the influence of [HDDs] on gas usage."<sup>83</sup> As proof, UCA points to the use of income and gross domestic product in the regression analysis. UCA states that neither has an impact on HDDs.<sup>84</sup>

## **3. Analysis**

82. The ALJ finds and concludes that use of Staff's 10-year average in calculating the normal HDDs is the most reasonable. The ALJ agrees that "[d]efining normal weather using average temperatures over the most recent 10-year period is likely to be a more accurate reflection of current and future temperatures in the utility's service territory than an average that extends further into the past."<sup>85</sup> Like the Commission in Proceeding No. 17AL-0429G, the ALJ further

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<sup>81</sup> Atmos' SOP at 11.

<sup>82</sup> Hearing Exhibit 402 at 7:3-8 (Answer Testimony of Dr. England).

<sup>83</sup> UCA's SOP at 27.

<sup>84</sup> *Id.*

<sup>85</sup> Hearing Exhibit 303 at 20:17-21:3 (Answer Testimony of Mr. Haglund).

finds and concludes that Atmos' regression analysis "produces the most accurate results and thus makes the test-year reflect the most accurate weather-normal year."<sup>86</sup>

#### **D. Capital Structure**

83. The Colorado Supreme Court has held that the Commission should use a utility's actual capital structure that finances the utility's operations in calculating rates, unless it is demonstrated by a substantial showing that ratepayers are materially prejudiced by the actual capital structure that finances utility operations.<sup>87</sup> Atmos' currently-approved capital structure is 44.42 percent debt and 55.58 percent equity, which resulted from its last Phase I Rate Case filed in 2017.<sup>88</sup>

##### **1. Atmos**

84. Atmos argues that the Commission should use a capital structure as of October 31, 2022 of 40.75 percent long-term debt and 59.25 percent equity to set rates in this proceeding.<sup>89</sup> According to Atmos, such a structure is its actual capital structure as of October 31, 2022 with one exception, which is that the long-term debt Atmos borrowed to cover the costs of Winter Storm Uri has been excluded.<sup>90</sup> Atmos did this because it "issued medium term debt (2 years) to cover those expenses, the majority of which will be securitized by a Texas state agency before the end of calendar year 2022."<sup>91</sup>

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<sup>86</sup> Decision No. R18-0014 issued in Proceeding No. 17AL-0429G on January 8, 2018 at 50 (¶ 140).

<sup>87</sup> *Peoples Natural Gas v. Public Utilities Comm'n*, 567 P.2d 377 (Colo. 1977).

<sup>88</sup> Decision No. C18-0311 issued in Proceeding No. 17AL-0429G on May 5, 2018 at 17 (¶ 51).

<sup>89</sup> Atmos' SOP at 13.

<sup>90</sup> Hearing Exhibit 102 at 49:1-4 (Direct Testimony of Mr. Christian).

<sup>91</sup> *Id.*

85. Atmos employed the actual capital structure less the Winter Storm Uri debt as of October 31, 2022, rather than the end of the test period (March 31, 2022), because it issued \$800 million in debt in October 2022.<sup>92</sup> In her Answer Testimony, Ms. Sigalla on behalf of Staff had recommended the inclusion in the capital structure of the October 2022 debt issuance because otherwise Atmos's capital structure would be artificially high in equity.<sup>93</sup> Atmos agrees to include the \$800 million debt issuance in its capital structure, but only if the entirety of the capital structure (*i.e.*, both debt and equity) is measured as of October 31, 2022, not just the debt.<sup>94</sup>

## 2. Intervenors

### a. Staff

86. Staff recommends a capital structure of 42.22 percent long term debt and 57.78 percent equity. Staff asserts that it is difficult to come up with a fair capital structure in this proceeding because Atmos' borrowing to pay the costs of Winter Storm URI has distorted Atmos' actual capital structure. Staff faults Atmos for bringing this proceeding while the debt incurred to pay for the costs of Winter Storm Uri, which was an extraordinary event, is still on Atmos' books.<sup>95</sup> As evidence, Staff points to the following table that shows the impact of the Winter Storm Uri financing on Atmos' capital structure:<sup>96</sup>

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<sup>92</sup> See Hearing Exhibit 301 at 65: 1-3 (Table FDS-13) (Answer Testimony of Ms. Sigalla) (Atmos' actual capital structure (including the Winter Storm Uri debt) as of March 31, 2022 was 47 percent debt and 53 percent equity).

<sup>93</sup> Hearing Exhibit 301 at 68:1-12 (Answer Testimony of Ms. Sigalla).

<sup>94</sup> Hearing Exhibit 112 at 34:1-19 (Rebuttal Testimony of Mr. Christian).

<sup>95</sup> Staff's SOP at 7-8; Hearing Exhibit 301 at 64:8-65:12 (Answer Testimony of Ms. Sigalla).

<sup>96</sup> Hearing Exhibit 301 at 66:4-7 (Table FDS-14) (Answer Testimony of Ms. Sigalla).

	<u>Shareholder Equity with Uri Financing</u>	<u>Shareholder Equity Without Uri Financing</u>
3/31/2021	51.7	60.4
6/30/2021	51.5	60.2
9/30/2021	51.9	60.6
12/31/2021	51.0	59.0
3/31/2022	53.0	60.9
6/30/2022	53.8	61.7

87. Staff further states “that the resolution of the Texas proceeding is not yet concluded, and [Atmos] has not made clear to the Commission how securitization of the Texas and Kansas Storm Uri debt will impact Colorado ratepayers given that Kansas and Colorado share an operating division.”<sup>97</sup> Staff supports excluding the \$800 million in Winter Storm Uri financing from determining the capital structure, but does not believe that the resulting structure is either an accurate representation of what the capital structure would have been if Winter Storm Uri had not occurred, or fair to ratepayers.<sup>98</sup> Staff thus advocates for its “compromise” capital structure of 42.22 percent long term debt and 57.78 percent equity.

**b. UCA**

88. UCA recommends a capital structure of 53.0 percent equity and 47.0 percent debt, which is Atmos’ actual capital structure in March 2022, including the debt taken on as a result of Winter Storm Uri.<sup>99</sup> As support, UCA points to: (a) Atmos’ capital structure in September 2022 of 46.38 percent debt and 53.62 percent equity before a securities issuance that took place that month

<sup>97</sup> Staff’s SOP at 7-8.

<sup>98</sup> Hearing Exhibit 301 at 56:1-59:7, 68:1-14 (Answer Testimony of Ms. Sigalla).

<sup>99</sup> UCA’s SOP at 8.

and 47.77 percent debt and 52.53 percent equity after the issuance;<sup>100</sup> and (b) Atmos' Commission-approved capital structure in rate cases filed in 2013, 2014, 2015, and 2017.<sup>101</sup> According to UCA, the capital structure it proposes in this proceeding is much closer than Atmos' proposed structure to Atmos' actual capital structure in September 2022 and the capital structures approved by the Commission in the listed rate cases.<sup>102</sup>

89. UCA also asserts that Atmos "should be taking greater advantage of cheaper debt capital rather than more expensive equity capital."<sup>103</sup> According to UCA, the increase from the currently approved equity percentage of 55.8 percent to Atmos' originally proposed level of 60.92 percent would increase Atmos' revenue requirement "by approximately \$1.5 million every year."<sup>104</sup> It also will "increase [Atmos'] returns, increase shareholder earnings, enhance shareholder value, and increase executive compensation—all at the expense of ratepayers."<sup>105</sup> UCA concludes that "Atmos Energy's decisions to increase the equity in its capitalization portfolio and to eschew cheaper debt is not just and reasonable, is not in the public interest, and results in a higher than necessary net revenue requirement and higher than necessary proposed rates to its Colorado ratepayers."<sup>106</sup>

90. Finally, UCA asserts that its proposed capital structure should not lead to a credit downgrade for Atmos because it is heavier in equity than Atmos' peers.<sup>107</sup> It also "far exceeds any

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<sup>100</sup> Hearing Transcript at 57:3-58:10 (January 6, 2023).

<sup>101</sup> Hearing Exhibit 401 at 10 (Table RAF-2) (Answer Testimony of Mr. Fernandez).

<sup>102</sup> UCA's SOP at 8-9.

<sup>103</sup> Hearing Exhibit 401 at 11:7-8 (Answer Testimony of Mr. Fernandez).

<sup>104</sup> *Id.* at 13:14-15.

<sup>105</sup> *Id.* at 15:16-18.

<sup>106</sup> *Id.* at 20:4-7.

<sup>107</sup> *Id.* at 11:16-12:2.

of the equity ratios authorized for any other natural gas utility in Colorado.”<sup>108</sup> UCA concludes that its proposed capital structure “will achieve the Company’s stated goals of financial integrity and access to capital, but at a more reasonable cost to ratepayers.”<sup>109</sup>

91. If a 53 percent equity and 47 percent debt capital structure is not ordered, UCA recommends: (a) a 52 percent equity and 48 percent debt structure, which the Commission authorized in two of Atmos’ recent rate cases; (b) a structure of 46.4 percent equity and 53.6 percent debt, which is the average capital structure of the proxy companies UCA has proposed to use in determining the return on equity in this proceeding; or (c) a range of equity from 52 percent to 55 percent, and a corresponding range of debt of 45 percent to 48 percent, which is what the Commission ordered in the recent rate case of Public Service.<sup>110</sup>

### 3. Analysis

92. The evidence establishes that Atmos is targeting a capital structure including short-term debt of 50 to 60 percent in equity.<sup>111</sup> While there is no direct evidence of Atmos’ capital structure without short-term debt, it stands to reason that the range of equity targeted by Atmos in its capital structure without short-term debt is lower. Nevertheless, Atmos is requesting a capital structure without short-term debt that includes 59.25 percent in equity, which it stands to reason is near or above the top-end of its targeted structure.

93. The record establishes that the debt acquired as a result of the extraordinary Winter Storm Uri has made it difficult to determine the appropriate capital structure to be used for establishing rates going forward. However, it is undisputed that: (a) a capital structure that is

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<sup>108</sup> *Id.* at 15:1-2.

<sup>109</sup> *Id.* at 22:22-23:1.

<sup>110</sup> *Id.* at 23:5-24:10 (including Table RAF-7).

<sup>111</sup> *Id.* at 18:10:19:1 & Attach, RAF-12.

higher in equity is more costly to ratepayers; (b) the capital structures approved by the Commission in Atmos' last four rate cases were significantly lower in equity;<sup>112</sup> (c) in two of those rate cases the Commission approved a capital structure other than Atmos' actual structure;<sup>113</sup> and (d) the highest equity percentage approved by the Commission in recent rate cases of regulated gas utilities is 53.78 percent, which was for Public Service, a utility that has the same beta and credit rating from Standard and Poors.<sup>114</sup>

94. Based on the foregoing, the ALJ finds and concludes that: (a) due to the extraordinary nature of Winter Storm Uri, it is appropriate to exclude the debt taken on to meet the unforeseen financial needs created by that event; and (b) an equity range of 55 to 58 percent is most likely to generate just and reasonable rates for ratepayers, maintain Atmos' credit rating, and thereby allow Atmos to continue accessing the debt markets at the lowest reasonable cost.<sup>115</sup>

## **E. Weighted Average Cost of Capital**

### **1. Return on Equity (ROE)**

#### **a. Atmos**

95. Atmos requests a ROE of 10.95 percent. Atmos' current approved ROE is 9.45 percent.<sup>116</sup> Atmos developed its ROE recommendation by utilizing the Constant Growth Discounted Cash Flow (CGDCF) model, the Multi-Stage Discounted Cash Flow (MSDCF) model, the Capital Asset Pricing Model (CAPM), the Empirical Capital Asset Pricing Model (ECAPM),

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<sup>112</sup> See Hearing Exhibit 401 at 10 (Table RAF-2) (Answer Testimony of Mr. Fernandez).

<sup>113</sup> *Id.* at 10:1-3.

<sup>114</sup> *Id.* at 14:10-11 (Table RAF-3); 24:1-8 (the Commission approved an equity range from 52 to 55 percent and PSCo chose 53.78).

<sup>115</sup> Hearing Exhibit 112 at 28:20-29:2 (Rebuttal Testimony of Mr. Christian).

<sup>116</sup> Decision No. C18-0311 issued in Proceeding No. 17AL-0429G on May 5, 2018 at 16 (¶ 46).

and the Risk Premium Model (RPM). Application of these models yielded a reasonable range of 9.32 to 11.64 percent including the MSDCF results or 9.73 to 12.03 percent excluding the MSDCF results.<sup>117</sup> Atmos then adjusted the range by 0.30 percent and negative 0.06 percent to reflect the Company's smaller relative size and lower credit risk, respectively, as compared to the Utility Proxy Group companies, and by 0.05 percent for flotation costs. The end result is a 10.95 percent ROE within a reasonable range of 9.61 to 11.93 percent including the MSDCF results or 10.02 to 12.32 percent excluding the MSDCF results.<sup>118</sup>

96. Atmos calculated its RPM ROE by using two models: the Predictive Risk Premium Model (PRPM) and a Total Market Approach (TMA).<sup>119</sup> Atmos calculated its CAPM ROE estimate using Betas averaged from *Value Line* and Bloomberg and a risk-free rate. Atmos' risk-free rate "is based on the average of the Blue-Chip consensus forecast of the expected yields on 30-year U.S. Treasury bonds for the six quarters ending with the third calendar quarter of 2023, and long-term projections for the years 2024 to 2028 and 2029 to 2033."<sup>120</sup> Atmos' RPM and CAPM-based recommended ROEs are 10.99 percent and 11.14 percent, respectively.<sup>121</sup>

97. Atmos used the market data of two proxy groups of putatively risk-comparable companies in the CGDCF model and the MSDCF model. The first – Atmos' Utility Proxy Group – included Atmos (the entire company, not just its Colorado operations), New Jersey Resources Corporation (NJRC), NiSource Inc. (NiSource), Northwest Natural Gas (Northwest Natural), One Gas, Inc., and Spire Inc. (Utility Proxy Group).<sup>122</sup> According to Atmos, each of these companies:

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<sup>117</sup> Hearing Exhibit 107 at 6:6-7 (Table 2) (Direct Testimony of Mr. D'Ascendis).

<sup>118</sup> *Id.*

<sup>119</sup> *Id.* at 26:5-9.

<sup>120</sup> *Id.* at 43:4-7.

<sup>121</sup> *Id.* at 39:4-6, 45:6-10.

<sup>122</sup> *Id.* at 16:1-3.

(a) was included in the Natural Gas Utility Group of Value Line’s Standard Edition; (b) has 60 percent or greater of fiscal year 2021 total operating income derived from, and 60 percent or greater of fiscal year 2021 total assets attributable to, regulated gas distribution operations; (c) has not publicly announced that it was involved in any major merger or acquisition activity (i.e., one publicly-traded utility merging with or acquiring another); (d) have not cut or omitted its common dividends during the five years ended 2021; (e) has Value Line and Bloomberg Professional Services adjusted Beta coefficients; (f) has positive Value Line five-year dividends per share growth rate projections; and (g) has Value Line, Zacks, or Yahoo! Finance consensus five-year earnings per share growth rate projections.<sup>123</sup> Atmos believes that its Utility Proxy Group “is highly representative of the risks and prospects faced by Atmos Energy.”<sup>124</sup>

98. Atmos used the same price, dividend and three- to five-year forecasts of earnings per share growth from Value Line, Zacks, and Yahoo! Finance in the CGDCF and MSDCF models,<sup>125</sup> In the MSDCF model, Atmos used a 5.56 percent long-term growth rate consisting of the “compound growth rate in the chain-weighted GDP for the period from 1929 through 2021, and a 2.33 percent inflation rate.”<sup>126</sup> The CGDCF and MSDCF models yielded recommended ROEs of 9.73 percent and 8.91 percent, respectively, for an average of 9.32 percent.<sup>127</sup> The range of results from the models using the Utility Proxy Group data was 9.32 to 11.64 percent including the MSDCF results, and 9.73 to 12.03 percent excluding the MSDCF results.<sup>128</sup>

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<sup>123</sup> *Id.* at 15:3-21.

<sup>124</sup> *Id.* at 16:7-8.

<sup>125</sup> *Id.* at 20:13-19.

<sup>126</sup> *Id.* at 23:19-21.

<sup>127</sup> *Id.* at 25:5 (Table 4).

<sup>128</sup> *Id.* at 50:5-8.

99. Atmos also ran the CGDCF and MSDCF models using the market data from a proxy group consisting of non-price regulated companies (Non-Utility Proxy Group) as a check against the results of using only the Utility Proxy Group. Atmos did this because it contends that “non-price regulated firms operating in the competitive marketplace make an excellent proxy group if they are comparable in total risk to the Utility Proxy Group being used to estimate the cost of common equity.”<sup>129</sup> Atmos believes that its non-price regulated proxy group is comparable in risk to both the Utility Proxy Group and Atmos. Application of the models to the Non-Utility Proxy Group resulted in a recommended ROE of 11.64 percent within a reasonable range of 9.84 to 11.84 percent including the results from the MSDCF model and 12.03 percent within a reasonable range of 11.92 to 12.65 percent excluding the MSDCF results.<sup>130</sup>

100. Based on all of this information, Atmos concluded that the appropriate ROE is 10.95 percent.

**b. Intervenors**

**(1) Staff**

101. Staff argues for a ROE of 9.2 percent within a reasonable range of 9.2 to 9.45 percent. Staff contends that Atmos’ proxy group is not representative of the risks faced by Atmos because the utilities included are too large and operate in multiple jurisdictions. Staff stresses that “Atmos Colorado is a small utility that serves 125,000 customers”<sup>131</sup> and Atmos has focused on its Colorado operations – and not its multistate operations – for ratemaking purposes. As a result, Staff contends that it is illogical to use a proxy group consisting of large multistate

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<sup>129</sup> *Id.* at 46:7-9.

<sup>130</sup> *Id.* at 49:14 (Table 10).

<sup>131</sup> Staff’s SOP at 9.

utilities because they do not include the same risks as Atmos's Colorado operations. Staff argues that Atmos has effectively conceded this problem with its proxy group by applying an arbitrary size adjustment to its proposed reasonable range.<sup>132</sup>

102. Staff further asserts that Atmos' use of a growth rate of 5.56 percent based on data starting in 1929 in its MSDCF improperly is unrealistic and thus skews the results upwards. According to Staff, "[w]hen forecasters are currently assuming a long-term growth rate for the whole economy of 3.5 percent, it is unfathomable to conclude that a utility will grow nearly 5 percent greater than the rest of the economy – more than twice as fast as the rest of the economy – into perpetuity."<sup>133</sup> Staff believes that the Congressional Budget Office's forecast of nominal GDP growth of 3.72 percent over the next 30 years (consisting of a real growth rate of 1.62 percent and inflation of 2.06 percent) is more reliable.<sup>134</sup> Staff used CBO's rate with a proxy group including all of the companies used by Atmos except for Atmos Energy Corporation in the CGDCF and MSDCF models and the result is a ROE range of 9.2 to 9.45 percent.<sup>135</sup>

103. Finally, Staff argues that flotation costs are built into prices for equity. As a result, the flotation cost adjustment is unnecessary and, like the other adjustments, reveals that Atmos modeling is flawed.<sup>136</sup> Staff concludes that Atmos' ROE should be set at 9.2 percent for ratemaking purposes.

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<sup>132</sup> *Id.* at 10.

<sup>133</sup> Hearing Exhibit 301 at 39:14-40:12 (Answer Testimony of Ms. Sigalla).

<sup>134</sup> *Id.* at 41:14-42:11.

<sup>135</sup> *Id.* at 47:1-10.

<sup>136</sup> *Id.* at 49:6-52:9.

**(2) UCA**

104. UCA recommends a 9.4 percent ROE within a range of reasonableness of 9.2 to 9.7 percent. To get there, UCA employed the CAPM, CGDCF, and MSDCF models, and reviewed and the Commission's ROE decisions in recent Public Service and Black Hills' rate cases. UCA also focused on the 9.42 percent average of ROE's awarded to gas utilities in the first three quarters of 2022.<sup>137</sup>

105. UCA's CAPM analysis yielded an estimated ROE of 9.5 percent.<sup>138</sup> In contrast, Atmos' CAPM analysis produced an estimated ROE of 10.83 percent.<sup>139</sup> According to Mr. Fernandez (UCA's ROE witness), "[t]he largest difference between our two analyses was due to the equity risk premiums selected. I used historical equity risk premiums, while [Atmos] used an average of six equity risk premiums, some using historical methodologies and some using forecasted methodologies."<sup>140</sup>

106. In conducting its CGDCF and MSDCF analysis, UCA used a proxy group consisting of all of the companies in Atmos' Utility Proxy Group, except that UCA excluded Atmos (due to concerns about "circular logic") and added Southwest Gas Corporation.<sup>141</sup> UCA used stock price averages for the third quarter of 2022. UCA's estimated ROE from its CGDCF analysis averaged 9.7 percent within a range of 8.9 to 10.7 percent.<sup>142</sup> According to Mr. Fernandez, "[t]he main difference between [the CGDCF] analyses [of Atmos and UCA] are

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<sup>137</sup> Hearing Exhibit 401 at 63:13-15 (Answer Testimony of Mr. Fernandez).

<sup>138</sup> *Id.* at 35:13-15.

<sup>139</sup> *Id.* at 36:1-4.

<sup>140</sup> *Id.* at 39:7-10.

<sup>141</sup> *Id.* at 42:9-43:13

<sup>142</sup> *Id.* at 42:4-8.

slightly different proxy groups and I used more recent data that was available when I prepared my testimony.”<sup>143</sup>

107. In its MSDCF analysis, UCA used:

[t]he long-term growth rate of 5.52% [] based on the real GDP growth rate of 3.17% from 1929 through 2021, and an expected inflation rate of 2.35%. The GDP growth rate is calculated as the compound growth rate in the chain-weighted GDP for the period from 1929 through 2021. The expected inflation rate is calculated using the average difference in the yields of the 30-year Treasury Bonds and the 30-year Treasury Inflation Protected Securities (“TIPS”) for the past year.

According to Mr. Fernandez,

The main differences between [the MSDCF analyses of Atmos and UCA] are slightly different proxy groups and I used more recent data that was available when I prepared my testimony. In addition, [Atmos] added an additional long-term growth rate and partially calculated inflation with Blue Chip Financial forecasts.<sup>144</sup>

According to UCA, the Blue Chip Financial inflation forecasts have “a horrible forecasting track record” and “have been biased upward.”<sup>145</sup> UCA’s MSDCF analysis produced an estimated ROE of 9.2 percent within a range of 8.9 to 9.8 percent.<sup>146</sup> Finally, “UCA [] recommends that the Commission use Multi-Stage growth DCF models as the primary model used to determine its authorized ROE for consistency with prior decisions and the wide use of this ROE model throughout the country.”<sup>147</sup>

108. Finally, UCA focused on ROEs awarded to utilities in Colorado and elsewhere. UCA noted that in the recently completed gas rate case for Public Service,<sup>148</sup> the Commission

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<sup>143</sup> *Id.* at 45:18-20.

<sup>144</sup> *Id.* at 54:20-55:2.

<sup>145</sup> *Id.* at 55:13, 56:1.

<sup>146</sup> *Id.* at 53:1-2.

<sup>147</sup> *Id.* at 59:10-13.

<sup>148</sup> Proceeding No. 22A-0345G.

authorized a ROE within the 9.2 to 9.5 percent range. Public Service chose a ROE of 9.2 percent. Earlier, Public Service was authorized a 9.20 percent ROE in Proceeding 20AL-0046G, Public Service was authorized a 9.30 percent ROE in its electric rate case in Proceeding 21AL-0317E, Black Hills Colorado Gas, Inc. was authorized a 9.20 percent in Proceeding 21AL-0236G, and Black Hills Colorado Electric, Inc. was authorized a 9.37 percent ROE in Proceeding 16AL-0326E.<sup>149</sup> UCA noted that the slightly higher ROE's authorized for electric utilities is explained by the fact that electric utilities are generally viewed as slightly riskier than gas utilities.<sup>150</sup> UCA also presented evidence that the average authorized ROE for all U.S. gas utilities in 2021 and the first three quarters of 2022 was 9.54 percent and 9.42 percent, respectively.<sup>151</sup> In the fourth quarter, UCA states that the average awarded ROEs in the US remained about the same as the first three quarters if a high-side outlier (10.2 percent) and an order that applied to both a Wisconsin gas and electric utility are removed from the analysis.<sup>152</sup> Even if they are not, UCA contends that the annual average in 2022 was around 9.5 percent.<sup>153</sup>

109. UCA noted that U.S. Treasury bond yields increased in 2022 due to Federal Reserve actions. However, UCA also stated that the long-term yield trend remains down, noting that “[t]he 30-year Treasury Bond yields sat at 3.13 percent in May 2018 when the Commission’s order in the last Atmos gas rate case was issued, which is just about the same as the average Treasury Bond yields in the third quarter of 2022.”<sup>154</sup> UCA thus concluded that “Atmos’ ROE in this gas rate case should be at or lower than the 9.45 percent ROE that the Commission authorized in the last Atmos

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<sup>149</sup> Hearing Exhibit 401 at 62:20-63:7 (Answer Testimony of Mr. Fernandez).

<sup>150</sup> *Id.* at 64:7-16.

<sup>151</sup> *Id.* at 63:8-19.

<sup>152</sup> Hearing Transcript at 61:14-63:3, 69:22-72:15 (January 9, 2023).

<sup>153</sup> *Id.* at 72:4-15.

<sup>154</sup> Hearing Exhibit 401 at 65:17-20 (Answer Testimony of Mr. Fernandez).

gas rate case (17AL-0429G).”<sup>155</sup> Based on the foregoing, UCA recommends a 9.4 percent ROE within a range of reasonableness of 9.2 to 9.7 percent.

**c. Analysis**

**(1) Legal Standard**

110. Atmos’ gas utility operations are capital-intensive, which makes the determination of the authorized ROE of critical significance to its cost of service. The authorized ROE must be sufficient to support the Company’s capital requirements, since necessary investments are made to provide adequate and reliable service.

111. In determining the ROE, the Commission must satisfy the standards articulated in *Bluefield Waterworks and Improvement Co. v. Public Service Comm’n. of West Virginia*, 262 U.S. 679 (1923) and *Federal Power Comm’n. v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). Atmos’ authorized ROE must be similar to the returns to investors who own shares in other businesses that have comparable financial characteristics and business risks. *Bluefield* and *Hope* further require that the established ROE supports Atmos’ financial integrity, including its credit rating that serves as a basis for securing debt at reasonable rates. Setting the ROE is a balancing act. If it is set unreasonably high, ratepayers may be burdened with excessive costs and current investors could receive a windfall. If it is set too low, service quality may be jeopardized, because Atmos will not be able to raise new capital on reasonable terms.

**(2) Conclusion**

112. The ALJ has given thorough consideration to the parties’ analyses. The wide range of results and the divergence of positions on inputs and assumptions confirm the need for the

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<sup>155</sup> *Id.* at 67:5-6.

Commission to exercise its judgment in considering the various factors that explain the differences in the calculations. The ALJ examined and considered the quantitative results of each rate of return model presented by the parties in this proceeding. All of the methodologies presented in this proceeding are generally accepted by the rate of return analyst community. In the determination of the ROE, no single rate of return model was favored, and the ALJ agrees in principle that each model result has validity and should be appropriately considered.

113. The ALJ also gave thorough consideration to the parties' arguments concerning qualitative factors that affect the risk profile of the Company. These factors include the financial stability afforded to Atmos by the SSIR, the historically low level of U.S. Treasury and utility bond yields (notwithstanding the recent increases), the perception of Atmos in the marketplace as evidenced by its stock price and credit agency rating, the low likelihood of a credit agency downgrade of Atmos, the trends in authorized ROEs for natural gas utilities, Atmos' ability to access capital, and Atmos' high equity ratio compared to its peers. Taken as a whole, these factors lend credibility to an ROE that is on the lower end of the spectrum between the position of Atmos and the Intervenors.

114. On balance, the ALJ finds that the analyses of the Intervenors generally supporting stability in Atmos' authorized ROE is more persuasive than Atmos' conclusion that its ROE should increase. In particular, the ALJ concludes that Atmos' request for an increase to 10.95 percent is not well supported. In the determination of the range of reasonableness and ROE, the ALJ used a variety of inputs and considered all of the rate of return models used by the parties, but the ALJ did not consider flotation costs, as the Commission has consistently rejected them, and no party presented a compelling reason to reverse course and include flotation costs in this proceeding.

115. Interest rates have steadily risen and are expected to continue to rise. Therefore, it is not reasonable for the range to extend below 9.3 percent as suggested by Staff and UCA. At the same time, the range cannot extend as high as Atmos' request for an ROE above 10.0 percent. The authorized ROEs established elsewhere nationally, and historic ROEs awarded to Public Service and other Colorado utilities relative to national averages instead support a top end of the range at 9.6 percent.

116. Based on the foregoing, the range of reasonableness for the ROE in this proceeding is 9.3 to 9.6 percent.

## **2. Cost of Long-Term Debt**

### **a. Atmos**

117. Atmos requests that the cost of long-term debt be set at 3.97 percent for rate-making purposes.<sup>156</sup> Atmos contends that this is its actual cost of long-term debt as of October 31, 2022, which includes the \$800 million debt issuance in October 2022 and excludes the Winter Storm Uri financing.<sup>157</sup> Atmos believes that the Winter Storm Uri debt should not be included because “unlike the Company's other long-term debt these [Winter Storm Uri debt] issuances were not to support long-term investment in infrastructure but to meet an immediate unforeseen need to that put significant pressure on our existing short-term debt facilities.”<sup>158</sup>

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<sup>156</sup> Hearing Exhibit 112 at 35:7-8 & Attach. JTC-7 at 10 (Rebuttal Testimony of Mr. Christian).

<sup>157</sup> *Id.* at 30:18-31:6, 34:10-15.

<sup>158</sup> *Id.* at 31:2-5 (quoting Atmos' Response to UCA Discovery Request 4-10.).

**b. Intervenors****(1) Staff**

118. Staff believes “[t]his is a difficult time to be setting rates because the cost of debt is undoubtedly affected by the Winter Storm Uri financing.”<sup>159</sup> However, because Atmos included the \$800 million debt issuance in October 2022, Staff supports Atmos’ requested cost of long-term debt.<sup>160</sup> Staff lauds Atmos for entering into interest rate swap agreements for \$1.850 billion in future debt issuances in September 2021. According to Staff, “[c]ompared to the current interest environment, these interest rate swap agreements will generate lower financing costs than would otherwise be available without the agreements.”<sup>161</sup>

**(2) UCA**

119. UCC requests that the long-term cost of debt be set at 3.06 percent for ratemaking purposes. This is “Atmos’ actual weighted average cost of debt as of the end of the March 2022 HTY,”<sup>162</sup> which includes the Winter Storm Uri financing. According to UCA, the Commission has not previously allowed utilities to exclude selected debt issues.<sup>163</sup> Allowing Atmos to do so in this proceeding by removing the Winter Storm Uri debt “results in a capital structure that becomes unreasonably equity heavy and unreasonably expensive . . . and, thus, will not result in just and reasonable rates that would be in the public interest.”<sup>164</sup>

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<sup>159</sup> Staff’s SOP at 8 (quoting Hearing Exhibit 301 at 71:5-11 (Answer Testimony of Ms. Sigalla)).

<sup>160</sup> *Id.* at 8 (incorrectly stating that Atmos’ requested cost of long-term debt is 3.94 percent).

<sup>161</sup> Hearing Exhibit 301 at 70:11-16 (Answer Testimony of Ms. Sigalla).

<sup>162</sup> UCA’s SOP at 9.

<sup>163</sup> *Id.* (citing Hearing Exhibit 401 at 25:10-11 (Answer Testimony of Mr. Fernandez)).

<sup>164</sup> *Id.* at 9-10.

**c. Analysis**

120. Based on the evidence in this Proceeding, the ALJ finds and concludes that a 3.97 percent cost of long-term debt as proposed by Atmos, and Staff will yield just and reasonable rates. The ALJ further finds and concludes that this debt cost level best reflects the anticipated costs of borrowing when the new base rates established in this Proceeding will be in effect.

**3. Weighted Average Cost of Capital (WACC)**

121. Atmos' weighted average cost of capital (WACC) is calculated as the combination of the authorized capital structure and the specific authorized costs of capital within that structure. Because the WACC represents the general return on rate base for ratemaking purposes, the WACC enters the COSS for the purpose of determining revenue requirements for the test year. Atmos' currently approved WACC is 7.55 percent.<sup>165</sup>

122. Atmos, Staff, and UCA request a WACC of 8.11, 6.94,<sup>166</sup> and 6.42 percent, respectively.<sup>167</sup>

123. Consistent with the discussion above related to the ranges authorized for ROE and equity ratio, the ALJ sets the WACC at 7.0 percent. The ALJ finds and concludes that this rate of return on rate base balances the interests of Atmos and its ratepayers consistent with the tenets of *Hope* and *Bluefield*. The ALJ further finds and concludes that a 7.0 percent WACC, in combination with the ranges for the ROE and the equity ratio, will permit Atmos to satisfy the financial metrics and preserve its credit rating.

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<sup>165</sup> Decision No. C18-0311 issued in Proceeding No. 17AL-0429G on May 5, 2018 at 18 (¶ 53).

<sup>166</sup> Hearing Exhibit 301 at 9 (Table FDS-2).

<sup>167</sup> Hearing Exhibit 112 at 35:9-12 (Rebuttal Testimony of Mr. Christian); Hearing Exhibit 301 at 9 (Table FDS-2) (Answer Testimony of Ms. Sigalla); Hearing Exhibit 401 at 6:14 (Answer Testimony of Mr. Fernandez).

## F. Depreciation Expense

### 1. Atmos

124. Atmos proposes to continue to apply the existing Colorado Direct depreciation rates approved in Proceeding No. 15AL-0299G but adopt select rates from its September 30, 2019, Shared Services Unit depreciation study and in the September 30, 2021, Colorado-Kansas General Office Property depreciation study. Consistent with its end of period rate base approach, Atmos proposes an end of period balance for accumulated reserve for depreciation.<sup>168</sup> Atmos then made a \$1,074,534 “known and measurable” increase to its depreciation expense<sup>169</sup> “because [Atmos’] depreciation expense increased to a known and measurable level over the course of the HTY.”<sup>170</sup> The net effect of this known and measurable adjustment is “to increase Atmos’ revenue deficiency by about \$1.1 million.”<sup>171</sup> According to Atmos, “to not reflect the known higher expense would deny the Company a reasonable opportunity to recover the higher expense.”<sup>172</sup>

125. In its Rebuttal Testimony, Atmos agrees to adopt the proposal by Staff to change select depreciation rates related to Colorado direct investment.<sup>173</sup> Specifically, Staff proposed to adopt the rates proposed for the ten accounts with a proposed increase in depreciation rates in the September 30, 2021 Colorado-Kansas General Office Property Depreciation Rate Study undertaken by Atmos.<sup>174</sup> This results in in “an estimated additional March 31, 2022, HTY

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<sup>168</sup> Hearing Exhibit 102 at 20:21-21:2 (Direct Testimony of Mr. Christian).

<sup>169</sup> Hearing Exhibit 112, Attach. JTC-7, Rev. 1 at 7. *But see* Hearing Exhibit 400.

<sup>170</sup> Atmos’ SOP at 19.

<sup>171</sup> UCA’s SOP at 21.

<sup>172</sup> Hearing Exhibit 112 at 22:19-23:3 (Rebuttal Testimony of Mr. Christian).

<sup>173</sup> Hearing Exhibit 111 at 6:22-23 (Rebuttal Testimony of Mr. Armstrong).

<sup>174</sup> Hearing Exhibit 108, DAW-3 (Direct Testimony of Mr. Watson).

depreciation expense increase of approximately . . . \$322k (if 13 Mo. Average based) using the Company's HTY ending March 31, 2022.”<sup>175</sup>

## 2. Intervenors

### a. Staff

126. “Staff generally has no objection to the Company's depreciation rates.” However, Staff recommends two adjustments to Atmos' depreciation proposal. First, Staff proposes to increase depreciation rates for the ten Colorado investments summarized above. As support, Staff states:

Staff is proposing to increase Colorado Direct depreciation rates due to Colorado's climate goals. Cognizant of the Commission's recent interest in a gradualist approach that better aligns the utilities depreciation cost recovery with the (still evolving) statewide policy goals of reducing greenhouse gas emissions, as specifically recognized by SB 21-264, Staff finds it reasonable to increase Colorado Direct depreciation rates in this Proceeding.<sup>176</sup>

As noted above, Atmos agrees to this change.

127. Second, Staff proposes to calculate depreciation expense based on the use of the 13-month average method for calculating rate base, as opposed to the year-end method.<sup>177</sup>

### b. UCA

128. UCA opposes Atmos' proposed approximately \$1.1 million increase to its depreciation expense. As support, UCA states that Atmos did not carry its burden of justifying the adjustment.<sup>178</sup> UCA concedes that some justification was provided at the hearing on redirect, but

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<sup>175</sup> Hearing Exhibit 304, Rev. 1 at 26:1-3 (Answer Testimony of Mr. Lugo).

<sup>176</sup> *Id.* at 26:7-12.

<sup>177</sup> *Id.* at 27:1-28:8.

<sup>178</sup> UCA's SOP at 20-21.

contends that that was insufficient and prejudicial.<sup>179</sup> UCA argues that Atmos was required to justify the adjustment in its direct case, or at least in its rebuttal case. According to UCA, Atmos did neither.<sup>180</sup>

129. UCA also contends that Atmos' proposed adjustment "violates the matching principle and creates a mismatch with other elements in the revenue requirement." For example,

[b]y not making a customer annualization revenue adjustment, customers are denied the additional revenue which would decrease their base rates in the revenue requirement model. [Atmos] made an adjustment to increase Atmos' revenue deficiency by about \$1.1 million but did not make any adjustments to decrease its revenue deficiency.<sup>181</sup>

UCA thus characterizes the adjustment as "selectively one-sided."<sup>182</sup>

### 3. Analysis

130. Atmos' proposal regarding depreciation rates, as modified by Staff's proposal and agreed to by Atmos, is adopted. The ALJ finds and concludes that such an outcome is in the public interest and just and reasonable.

131. The ALJ further finds and concludes that Atmos has not carried its burden with respect to its proposed approximately \$1.1 million adjustment. Atmos direct and rebuttal testimony do not provide sufficient explanation for the proposed adjustment. While Atmos attempted to provide the justification during redirect questioning at the hearing, the testimony was insufficiently clear to allow the ALJ to conclude the adjustment is in the public interest. Even if it was clear, providing such an explanation on redirect at the hearing is prejudicial to the other parties the Commission, and the ratepayers. Accordingly, Atmos' proposed adjustment is denied.

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<sup>179</sup> *Id.* at 20 (citing Hearing Transcript at 130:3-132:11 (January 6, 2023)).

<sup>180</sup> *Id.*

<sup>181</sup> *Id.* at 21.

<sup>182</sup> *Id.* at 22.

## **G. Employee Compensation and Board of Directors Costs**

### **1. Atmos**

132. Atmos requests to recover all reasonable costs associated with both its fixed and variable employee compensation programs and Board of Directors (BOD) compensation costs. Atmos' Variable Pay Plan (VPP) and Management Incentive Plan (MIP) "are designed to retain employees and provide an incentive for those employees to reduce Company expenses or increase revenues."<sup>183</sup> Atmos' Long-Term Incentive Plan (LTIP) provides equity-based incentives to employees and non-employee directors achieve longer-term goals. Atmos states that it must "fairly compensate its employees and BOD to maintain a well-run company capable of providing safe and reliable service. . . , [which] benefits customers."<sup>184</sup> Disallowing such costs would deny Atmos "a fair opportunity to recover the market-based compensation paid to its employees."<sup>185</sup> The amounts sought by Atmos are \$773,589 for the VPP and MIP programs, \$214,530 for the LTIP program, and \$116,132 for the BOD.<sup>186</sup>

### **2. Intervenors**

#### **a. Staff**

133. Staff asserts that ratepayers and shareholders should evenly share the costs of Atmos' employee compensation programs because "both benefit from the efforts of Company Staff." Specifically, "[t]he benefits of employee performance and retention filter not just to ratepayers, but to shareholders as well, for the better and more efficiently the Company operates,

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<sup>183</sup> Atmos' SOP at 18.

<sup>184</sup> *Id.*

<sup>185</sup> *Id.* at 19.

<sup>186</sup> Hearing Exhibit 300, Rev. 1 at 61 (Table NTG-9), 76:6-11 (Answer Testimony of Ms. Ghebregziabher).

the more shareholders will gain.”<sup>187</sup> Staff thus requests that ratepayers and shareholders split the costs of the VPP and MIP programs 50-50. Alternatively, Staff requests to limit VPP and MIP recovery by Atmos to 15 percent of base salary, applied on a per-employee basis.<sup>188</sup> As support, Staff cites recent Commission decisions limiting utility recovery of VPP and MIP costs.<sup>189</sup>

134. Staff proposes to deny all recovery of LTIP costs. As support, Staff points to one study finding that LTIP programs do not effectively improve employee performance or benefit ratepayers.<sup>190</sup> Staff also points to Commission decisions since 2016 denying recovery of LTIP costs.<sup>191</sup> Staff thus requests the denial of recovery of \$214,530 in LTIP-related costs.<sup>192</sup>

135. Finally, Staff requests that ratepayers pay only 50 percent of the BOD costs, with shareholders paying the remainder. As justification, Staff states that “shareholders [] stand to benefit from BOD compensation, if not primarily, then at least to a large degree.”<sup>193</sup> Staff also points to the Commission’s decision in Public Service’s recent rate case to allow Public Service to recover from ratepayers only 50 percent of BOD costs.<sup>194</sup>

#### **b. UCA**

136. UCA recommends disallowing all LTIP costs. UCA believes that such programs benefit shareholders, and not ratepayers. UCA also cites the decisions in Proceeding Nos.

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<sup>187</sup> Atmos’ SOP at 21.

<sup>188</sup> Hearing Exhibit 300, Rev. 1 at 71:7-72:8 (Answer Testimony of Ms. Ghebregziabher).

<sup>189</sup> *Id.* at 70:7-15 (citing Decision No. C22-0642 issued in Proceeding No. 22AL-0046G on October 25, 2022, at 63 (¶ 205)).

<sup>190</sup> *Id.* at 73:5-74:4.

<sup>191</sup> *Id.* at 74:5-12.

<sup>192</sup> *Id.* at 75:1-4.

<sup>193</sup> *Id.* at 78:1-2.

<sup>194</sup> *Id.* at 77:6-13.

22AL-0046G and 21AL-0236G in which the Commission disallowed half of the equity compensation expenses in support of its recommendation.<sup>195</sup>

### 3. Analysis

137. The ALJ recommends: (a) limiting recovery of the costs of VPP and MIP programs to 15 percent of base salary, applied on a per-employee basis; (b) eliminating recovery of the LTIP costs; and (c) limiting Atmos' recovery of the BOD compensation to 50 percent. These decisions are consistent with recent Commission decisions on the same points. In addition, the ALJ finds and concludes that the arguments by Staff and UCA on these issues are more compelling than the justifications provided by Atmos. It is appropriate for shareholders to shoulder some of the burden of these compensation issues from which both shareholders and ratepayers' benefit. The foregoing decisions fairly balances shareholder and ratepayer interests.

## H. Rate Case Expenses

### 1. Atmos

138. Atmos seeks to recover its actual rate case expenses in this proceeding.<sup>196</sup> Atmos estimated those expenses at the outset of the proceeding at \$750,000 and in Rebuttal Testimony reduced the estimate to \$600,000.<sup>197</sup> At the hearing, Atmos stated its belief that its estimate in its Rebuttal Testimony remains accurate.<sup>198</sup> Atmos proposes to file a document toward the end of the proceeding including its actual rate case expenses. According to Atmos, "the Colorado Supreme

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<sup>195</sup> UCA's SOP at 10 (citing Hearing Exhibit 401 at 90:20-91:2 (Answer Testimony of Mr. Fernandez)).

<sup>196</sup> Atmos' SOP at 24-25.

<sup>197</sup> Hearing Exhibit 112 at 64:3-4 & Attach. JTC-7 at tab WP-9 (Rebuttal Testimony of Mr. Christian).

<sup>198</sup> Hearing Transcript at 47:9-20 (January 6, 2023).

Court and this Commission have long recognized rate case expense as a recoverable operating expense.”<sup>199</sup>

## **2. Intervenors**

### **a. Staff**

139. In its SOP, Staff did not address the amount of rate case expenses sought by Atmos. In its answer testimony, Staff took issue with the amounts sought by Atmos of several items of rate case expenses. Staff’s answer testimony recommended “authoriz[ing] the recovery of the lower between \$594,611 and the actual amount of rate case expenses incurred and paid by Atmos.”<sup>200</sup> As noted above, Atmos revised its estimate of rate case expenses in its rebuttal testimony to \$600,000. Atmos agreed to a proposal by Staff and UCA to recover its rate case expenses over a 36-month amortization period, with no return on any unamortized balances.<sup>201</sup>

### **b. UCA**

140. UCA recommends denial of recovery of rate case expenses for two reasons. First, UCA contends that Atmos did not provide proper notice that it would seek recovery of rate case expenses in this proceeding.<sup>202</sup> UCA notes that Atmos’ Notice referenced a “net increase in annual gas base rate revenues [of] \$7,681,233,” and further stated that the requested “annual revenue increase reflects the increase to base rates and the proposed recovery of Rate Case Expenses.”<sup>203</sup> UCA concludes that the only reasonable interpretation of the Notice is that the \$7,681,233 revenue

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<sup>199</sup> *Id.* (citing *Mountain States Tel. & Tel. Co. v. PUC*, 576 P.2d 544, 547 (Colo. 1978); Decision No. R21-0400 issued in Proceeding No. 20AL-0432E on July 12, 2021 at 65 (¶ 151)).

<sup>200</sup> Hearing Exhibit 304, Rev. 1 at 16:13-14 (Answer Testimony of Mr. Rivera Lugo).

<sup>201</sup> Atmos’ SOP at 24; Hearing Exhibit 304, Rev. 1 at 16:11-16 (Answer Testimony of Mr. Rivera Lugo).

<sup>202</sup> Atmos’ SOP at 22-23.

<sup>203</sup> Hearing Exhibit 400, Rev. 1 at 59:1-3.

increase included the Rate Case Expenses. In other words, the public was not put on notice that the requested Rate Case Expenses were \$7,681,233 *plus* the Rate Case Expenses.<sup>204</sup> According to UCA, this violates Commission Rule 1207(f), which requires notices to “contain adequate information to enable interested persons to be reasonably informed of the purpose of the matter noticed.”<sup>205</sup>

141. Second, UCA argues that Atmos has not provided “sufficient factual support to show that the expenses were prudently incurred, and are just and reasonable.”<sup>206</sup> Specifically, UCA asserts that by providing an estimate and proposing to make a filing detailing its rate case expenses at the end of the proceeding, Atmos has not carried its burden of establishing at the hearing that the rate case expenses are just and reasonable.<sup>207</sup> UCA also takes issue, among other things, with Atmos’ estimated travel expenses of \$32,440. UCA states that “[f]lying in and hoteling employee witnesses and non-participating in-house counsel, for a *remote* Evidentiary Hearing, is not essential, is not a necessity but a ‘want’ for Atmos, is an unjust and imprudent expense that ratepayers should not be forced to pay, and shareholders should pay this unnecessary expense.”<sup>208</sup>

### 3. Analysis

142. The ALJ recommends authorizing recovery of rate case expenses for this Proceeding not to exceed \$650,000, amortized over three years, with no return. Atmos has done a good job of controlling rate case expenses in this proceeding, particularly when compared to rate case expenses in other recent rate case proceedings.

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<sup>204</sup> *Id.* at 59:6-17.

<sup>205</sup> *Id.* at 59:18-20. *See also* Rule 1207(f) of the Commission’s Rules of Practice and Procedure, 4 *Colorado Code Regulations* (CCR) 723-1.

<sup>206</sup> UCA’s SOP at 23.

<sup>207</sup> *Id.*

<sup>208</sup> *Id.* at 26 (emphasis in original).

143. The UCA's notice-based argument is unavailing. The ALJ finds and concludes that Atmos' Notice in this proceeding contained "adequate information to enable interested persons to be reasonably informed of the purpose of the matter noticed."<sup>209</sup> While it would have been better to specify that Rate Case Expenses will be added to the \$7,681,233 in increased annual base rate revenues specified in the Notice, it is extremely unlikely that any otherwise interested person interpreted the Notice the same as UCA's interpretation, chose not to intervene or provide public comments based on that interpretation, and would have intervened or filed public comments if the Notice included the specificity identified by UCA.

144. The ALJ finds and concludes that the UCA's other arguments for disallowance are without merit. Atmos' proposal to file a document later in the proceeding detailing its actually incurred rate case expenses is appropriate and does not justify disallowance. The ALJ finds and concludes that including in the revenue requirement rate case expenses up to \$650,000 is fair and reasonable.

## **I. Uncollectable Expenses**

### **1. Atmos**

145. Atmos argues that it should be allowed to recover uncollectable expenses related to bad debt through the GCA rather than through base rates. According to Atmos, removing uncollectable expenses from base rates would result in a decrease of \$790,616. Atmos asserts that recovery of uncollectable expenses through the GCA is appropriate given the volatility in gas costs, which creates uncertainty regarding the appropriate level of uncollectable expense to include in base rates.<sup>210</sup> According to Atmos, "[t]his would allow changes driven by natural gas commodity

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<sup>209</sup> Rule 1207(f) of the Commission's Rules of Practice and Procedure, 4 (CCR) 723-1.

<sup>210</sup> Hearing Exhibit 102 at 43:19-22 (Direct Testimony of Mr. Christian).

prices to be reflected in a tariff that is [a] dollar-for-dollar recovery from the customer.”<sup>211</sup> Atmos concludes that recovering actual uncollectable expense through the GCA is more equitable for both customers and Atmos.<sup>212</sup>

## 2. Intervenor

### a. Staff

146. Staff opposes recovering uncollectable expenses through the GCA because:

[t]he purpose of the GCA is to allow utilities to reflect in their rates for gas sales and gas transportation services the increases or decreases in gas costs, including gas commodity costs and upstream services costs. The GCA should not be used to expedite the recovery of bad debt or costs that the Company has not been able to recover from its customers.<sup>213</sup>

Staff further asserts that uncollectable expenses are not particularly volatile as a percentage of revenues and Atmos collects 100 percent of its uncollectable expenses through base rates in two states in which it operates (Louisiana and Mississippi).<sup>214</sup> Staff believes that the GCA should be reserved exclusively for Atmos’ recovery of gas costs, which can be volatile.

### b. UCA

147. UCA has not taken a position on this issue.

## 3. Analysis

148. The ALJ finds and concludes that Atmos has not carried its burden of establishing that uncollectable expenses should be removed from base rates and collected instead through the GCA. Staff is correct that the GCA was not designed as a vehicle to allow utilities to recover

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<sup>211</sup> *Id.* at 43:13-14.

<sup>212</sup> Atmos’ SOP at 20.

<sup>213</sup> Hearing Exhibit 300, Rev. 1 at 81:4-13 (Answer Testimony of Ms. Ghebregziabher).

<sup>214</sup> *Id.* at 80:18-81:8.

uncollectable expenses. Instead, it was designed to allow utilities to recover volatile gas commodity costs and gas transportation costs. Allowing Atmos to recover uncollectable expenses through the GCA is contrary to the purpose for which the GCA was created. In addition, UCA has noted the significant increase in costs recovered through the GCA, and the resulting increase on GCA's rates, since 2021.<sup>215</sup> The ALJ finds and concludes that adding uncollectable expenses to the GCA would not result in just and reasonable rates.

## **VI. PHASE II ISSUES**

149. The Phase II portion of the rate case determines how the revenue requirement (calculated in Phase I) is allocated across customer classes. The fundamental objective of Phase II is to ensure that the revenue burden is being equitably shared by the customer classes. A Class Cost of Service Study (CCOSS) is a detailed analysis that assigns costs to each customer class based on class consumption attributes. Different approaches can be used in constructing a CCOSS to allocate costs across the customer classes.

150. Three steps are used in creating a CCOSS. First, the revenue requirement determined in Phase I is functionalized by assigning certain costs to the functional categories of utility service. Second, the functionalized costs are classified by further assigning them into categories based on primary cost drivers. Third, the functionalized and classified costs are allocated to the ratepayer classes. Atmos has four ratepayer classes: residential, commercial, irrigation, and transportation. The sum of the costs allocated to the ratepayer classes equals Atmos' revenue requirement.

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<sup>215</sup> Hearing Exhibit 401, Rev. 1 at 21:4-25:2 (Answer Testimony of Mr. Skluzak).

151. Among the categories into which costs are classified in the second step above are the demand and customer categories. Demand costs are those necessary to meet system demand requirements. Customer costs are those that vary based with the number of customers on the system. Costs that are placed in the customer category are typically recovered through a fixed service and facilities charge that, because it is fixed, does not vary based on an individual ratepayer's usage. The remainder of costs are used to set the volumetric rate and other miscellaneous charges on customer bills.

**A. Class Cost of Service Study and Revenue Allocation**

**1. Atmos**

152. Atmos provided a CCOSS using the minimum distribution system (MDS) methodology to develop its proposed Services and Facilities charges and volumetric rates. However, Atmos did not mention its use of the MDS methodology in its direct testimony, much less explain it. As a result, the following summary of the MDS approach necessarily comes from the Answer Testimony of intervenors.

153. The MDS theory is based on the assumption:

that there is a zero or minimum size main necessary to connect the customer to the system that affords the customer an opportunity to take service if he so desires. . . [A]ll distribution mains are [thus] priced out at the historic unit cost of the smallest main installed on the system and assigned as customer costs. The remaining book cost of distribution mains is assigned to demand.<sup>216</sup>

“Thus, the MDS approach is a theoretical construct where a distribution system consists of equipment designed to meet the customers’ minimum load requirements.”<sup>217</sup>

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<sup>216</sup> Hearing Exhibit 403 at 16:21-17:4 (Answer Testimony of Mr. Peterson) (quoting The National Association of Regulatory Utility Commissioners, *Gas Distribution Rate Design Manual* (June 1989)).

<sup>217</sup> *Id.* at 17:5-6.

154. As a result of the use of the MDS approach, Atmos classifies as customer-related 65.47 percent of the investment and related costs of distribution mains (Account No. 376) and measuring and regulating station equipment (Account Nos. 378 and 379), which is then allocated among the customer service classes based on the average monthly number of bills in each class. The remaining 34.52 percent of distribution mains costs are classified to the demand cost classification, which is allocated among the customer service classes based on class coincident peak day demands.<sup>218</sup>

155. Based on us of the MDS methodology, Atmos' CCOSS results indicate that the Residential class revenue responsibility is being subsidized by the other three customer service classes.<sup>219</sup> For that reason, and because Atmos does not want to reduce rates for any class,<sup>220</sup> Atmos proposes that the entire revenue increase authorized by the Commission at the conclusion of this Proceeding be assigned to the Residential customer class. Thus, while the residential class receives a revenue increase of \$7,681,232, the Commercial, Irrigation, and Transportation classes do not receive any increase.<sup>221</sup> To collect this revenue, Atmos proposes to increase the monthly fixed Facilities charges for Residential customers from \$11.74 to \$14.00, which is a consequence of employing the MDS methodology to classify the costs of distribution mains. The remainder would be collected through an increase in volumetric rates for residential customers. The facilities and volumetric charges for the Commercial, Irrigation, and Transportation classes of customers would remain the same.<sup>222</sup>

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<sup>218</sup> *Id.* at 8:1-6.

<sup>219</sup> Hearing Exhibit 109 at 17:10-23, Attach. PHR-2 at 1 (lines 37-38) (Direct Testimony of Mr. Raab).

<sup>220</sup> Hearing Exhibit 109 at 18:18-19 (Direct Testimony of Mr. Raab).

<sup>221</sup> Hearing Exhibit 109, Attach. PHR-2 at 1 (lines 57) (Direct Testimony of Mr. Raab).

<sup>222</sup> Hearing Exhibit 103, Attach. GLS-2.

156. Atmos contends that the MDS approach “is commonly applied in gas utility class cost of service analysis.”<sup>223</sup> As support, Atmos cites Bonbright, which states that “[i]n actual practice the vast majority of utilities utilize some form of minimum system to classify costs.”<sup>224</sup> Atmos further contends that the Commission has never prohibited the use of the MDS theory for the classification of costs, as suggested by Staff and UCA. Instead, the Commission’s approach has been more nuanced. Specifically, in rejecting the use of the MDS theory in Proceeding No. R08-1127 the Hearing Commissioner limited his ruling to the facts of that proceeding, Proceeding No. 17AL-0477E was an electric case that involved “significant differences [in] how class cost of service studies are conducted” compared to gas cases, and the Commission approved the settlement agreement in Proceeding No. 14AL-0300G that was based on Atmos’ “use of the MDS approach to determine class revenue responsibility.”<sup>225</sup>

157. Finally, Atmos asserts that it “it makes more sense to treat the[] cost items [in Account Nos. 376, 378, and 379] as costs incurred so that customers will have the opportunity to take service in the future” than to assume that such costs “are related to the demands that future customers are anticipated to place on the system.”<sup>226</sup> Atmos thus concedes that the MDS approach is “not completely satisfactory,” but believes that it reaches the best outcome.<sup>227</sup> Atmos concludes that, on balance, “many activities reflected in the balances of accounts 376, 378, and 379 are not directly related to the provision of distribution service and are best classified as customer-related costs.”<sup>228</sup> Rejecting the MDS methodology and “[e]mploying a 100% demand approach to allocate

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<sup>223</sup> Hearing Exhibit 115 at 5:20-21 (Rebuttal Testimony of Mr. Raab).

<sup>224</sup> *Id.* at 9:5-7 (quoting Bonbright et al., *Principles of Public Utility Rates, Second Edition*, at 491-492 (1988)).

<sup>225</sup> *Id.* at 7:3-18.

<sup>226</sup> *Id.* at 11:5-11.

<sup>227</sup> *Id.* at 11:7.

<sup>228</sup> *Id.* at 4:21-5:2.

distribution mains would understate the fixed costs of serving customers year round and would lead to interclass subsidies, thereby impeding accurate price signals and potentially harming Colorado's emission reduction goals by encouraging subsidized customers to consume more natural gas.”<sup>229</sup>

## 2. Intervenor

### a. Staff

158. Staff objects to the use of the MDS approach for allocation of distribution main costs to customers.<sup>230</sup> Staff contends that the MDS approach is disfavored by the Commission, and limits the control of ratepayers over their bills. By moving a greater degree of cost recovery to fixed charges and away from volumetric charges, ratepayers have less ability to control their energy costs, and thus less incentive to conserve. Staff argues that “[i]t is telling that of the total \$266.8M in total rate base that the Company's rates are designed to collect, \$207.3M or 78% is classified by the Company as customer components,” which are collected through S&F charges, and 65 percent of total distribution main investments are classified as customer components.<sup>231</sup> Staff contends both percentages are far too high and are the consequence of using the MDS theory.<sup>232</sup> Based on the foregoing, Staff thus recommends that the Commission reject use of the MDS theory and maintain the S&F charge at its current level.<sup>233</sup>

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<sup>229</sup> Atmos' SOP at 21-22.

<sup>230</sup> Staff's SOP at 27.

<sup>231</sup> *Id.*

<sup>232</sup> *Id.*

<sup>233</sup> *Id.* at 28.

**b. UCA**

159. UCA also recommends rejecting the MDS approach for many of the same reasons as Staff. UCA notes that Atmos' witness on the MDS approach – Mr. Raab – admitted at the hearing that he is not aware of any decision in which the Commission approved the MDS cost classification approach for Atmos or any other Colorado gas utility.<sup>234</sup> UCA also contends that Atmos did not carry its burden of justifying use of the MDS approach or otherwise classifying any portion of Account Nos. 376, 378, and 379 to the customer cost category. As support, UCA points to Mr. Raab's admission that "it is true that I did not isolate my proposed classification factor for distribution mains investment and related costs for detailed analysis."<sup>235</sup>

160. UCA asserts that the MDS methodology is premised on the incorrect assumption that "some investment to make gas distribution service available is necessary for each customer, regardless of the customer's peak or annual service requirements."<sup>236</sup> This assumption thus leads to the conclusion of the MDS approach that at least some significant percentage of the costs of distribution mains should be classified as customer-related. However, UCA states that utilities do not design and build the minimum system necessary to provide service to all of their customers. Instead, they design and build their delivery systems based on the maximum requirements of the customers served by the systems. In other words, utility systems are designed and built to accommodate the peak loads that will be imposed on the systems.<sup>237</sup> As UCA states, "[i]t is not simply attaching new customers to the system that gives rise to utility plant expansion, it is the

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<sup>234</sup> UCA's SOP, Rev. 1 at 29 (citing Hearing Transcript at 193:7-194:3 (January 6, 2023)).

<sup>235</sup> *Id.* at 29 (quoting Hearing Exhibit 115 at 12:20-21 (Rebuttal Testimony of Mr. Raab)). *See also* Hearing Transcript at 194:20-197:18 (January 6, 2023).

<sup>236</sup> Hearing Exhibit 403 at 17:17-19 (Answer Testimony of Mr. Peterson).

<sup>237</sup> *Id.* at 18:2-10.

sustained peak day usage requirements of the new customers that will dictate the [necessary] distribution facilities.”<sup>238</sup>

161. UCA further notes that, while Atmos’ use of the MDS approach yields results showing that the Residential class is being subsidized by the Commercial, Irrigation, and Transportation rate classes, when the MDS approach to allocating cost is removed from the analysis the results reveal that the Residential class is subsidizing the other three rate classes. Atmos’ “proposed assignment of the total revenue increase to the Residential class [thus] results in having Residential customers provide an even larger subsidy to the other three classes than they already provide, and it drives rates in all customer classes further from their respective cost of service.”<sup>239</sup>

162. UCA thus recommends that the Commission reject Atmos’ MDS approach for cost classification and order Atmos to re-run its CCOSS without it.

**c. EOC**

163. EOC objects to Atmos’ use of the MDS approach for three primary reasons.

164. First, the use of the MDS “results in more distribution costs being unfairly and unreasonably allocated to the Residential class, and unreasonable increases to the monthly fixed customer charge.”<sup>240</sup>

165. Second, income-qualified (IQ) customers are harmed by a higher S&F charge. Collecting more of the cost of service from a fixed charge, rather than a volumetric charge, decreases the customers’ ability to control their bills. Higher fixed charges will thus

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<sup>238</sup> *Id.* at 18:15-18.

<sup>239</sup> *Id.* (quoting Hearing Exhibit 403 at 22:1-10 & Table DEP-6 (Answer Testimony of Mr. Peterson)).

<sup>240</sup> EOC’s SOP at 6.

disproportionately impact IQ customers who have a greater need to control their utility bills than non-IQ customers.<sup>241</sup>

166. Third, EOC contends that Atmos made a fundamental error in its application of the MDS theory. The NARUC Gas Rate Design Manual states that ““under the minimum inch main theory, all distribution mains are priced out at the historic unit cost of the smallest main installed in the system.”<sup>242</sup> While Atmos used 2-inch mains as the smallest in Atmos’ system for purposes of applying the MDS theory, Atmos has 1 and 1.25 inch mains in its system.<sup>243</sup> According to EOC, “the clear result of the Company’s misapplication of this method is that far more distribution facilities costs are classified as customer-related in the CCOSS.”<sup>244</sup>

167. Based on the foregoing, EOC recommends that the Commission “order Atmos to classify distribution facilities in FERC Accounts Nos. 376, 378, and 379 as demand-related. . . The end result will be a decrease to the Residential class, along with a decrease to the Residential Facilities charge.”<sup>245</sup>

### 3. Analysis

168. The ALJ will order Atmos to re-calculate its CCOSS without the use of the MDS classification method. Atmos has not carried its burden of establishing that use of the MDS will generate just and reasonable rates.

169. The assumption underlying the MDS methodology is that a large fraction of the costs of distribution mains can be allocated to the S&F charge because a significant portion of the

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<sup>241</sup> *Id.* at 6, 11-15.

<sup>242</sup> Hearing Exhibit 521.

<sup>243</sup> EOC’s SOP at 9-10.

<sup>244</sup> *Id.* at 10.

<sup>245</sup> *Id.* at 10-11.

investment and expense is customer-related rather than demand or commodity-related. In other words, the investment in distribution mains is primarily driven by the need for customers to be connected to the distribution system. It is much less driven by peak demand or usage.

170. MDS opponents generally argue that distribution main costs are primarily, if not exclusively, driven by peak demand considerations. UCA put it the most succinctly: “[i]t is not simply attaching new customers to the system that gives rise to utility plant expansion, it is the sustained peak day usage requirements of the new customers that will dictate the [necessary] distribution facilities.”<sup>246</sup> As a result, the allocation of the cost of the mains cannot be totally classified as customer-related and collected through the S&F charge.

171. As Atmos has conceded, there is no perfect cost allocation methodology for plant investments and expenses that is used by all customer classes. The ALJ has not been convinced that the use of the MDS methodology is superior to other methods of allocating common costs between fixed and variable rate elements. Additionally, the impact of this method on the rate structure is a relevant concern. The use of the MDS causes the S&F charge to the residential class to increase by 35 percent, and has additional price impacts on the total non-gas bill of the customers. Atmos has failed to persuade the ALJ that the increase in the S&F charge will benefit IQ customers. In fact, the ALJ finds and concludes that it is more likely to be prejudicial to IQ customers, and will create a disincentive for all customers to conserve.

172. The ALJ finds and concludes that the proposed use of the MDS methodology for rate design by Atmos is not in the public interest and will not yield just and reasonable rates. The ALJ further finds and concludes that Atmos has not carried its burden of establishing that the MDS accurately classifies or allocates the actual costs of the distribution main system in this case.

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<sup>246</sup> Hearing Exhibit 403 at 18:15-18 (Answer Testimony of Mr. Peterson).

Accordingly, Atmos is ordered to re-run its CCOSS and to revise its rates without the MDS methodology.

**B. Base Rate Design and Mitigation**

**1. Atmos**

173. As discussed above, Atmos' CCOSS showed that its non-residential rate classes (*i.e.*, Commercial, Irrigation, and Transportation) have been subsidizing the Residential rate class. Atmos subscribes to the view that rates should be cost-based, which based on the CCOSS results would lead to a substantial rate increase for the Residential class and rate reductions for the Commercial, Irrigation, and Transportation classes. However, Atmos also recognizes that imposing fully cost-based rates in this proceeding would cause rate shock to the Residential class. As a result, Atmos seeks to mitigate that shock by following the following rules: (a) in the face of an overall rate increase, no class will be provided with a rate decrease; (b) if a class is not providing sufficient revenues to cover its identified cost of service at proposed rate levels, required revenues will be increased for all deficient classes to a level that equalizes the return for those classes consistent with the identified cost of service. The result of this mitigation strategy is that the entire revenue deficiency identified by Atmos in the Phase I portion of the proceeding (\$7,890,428) is assigned to the Residential class.

174. Atmos "proposes to only increase the residential Facilities Charges in proportion to the overall increase proposed to the residential class."<sup>247</sup> The remainder of the revenue deficiency is recovered through the volumetric rate.

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<sup>247</sup> Hearing Exhibit 103 at 12:16-18 (Direct Testimony of Mr. Smith).

175. Atmos also proposes that the amounts collected by the Tax Credit Jobs Act (TCJA) and SSIR riders be rolled into base rates and reset to zero.<sup>248</sup> Thus, the new volumetric rate for the Residential Class would be the sum of the new rate (including 100 percent of the revenue deficiency), TCJA Adjustment, and SSIR. The new volumetric rate for non-Residential Classes would be the sum of the existing volumetric rate, TCJA Adjustment, and SSIR.<sup>249</sup>

176. Atmos requests a 12-month surcharge to recover rates case expenses and the refund of Excess Deferred Income Taxes (EDIT). According to Atmos, “[t]he proposed rates to recover these costs are spread to classes and rate structures in a proportionate manner through a General Rate Schedule Adjustment Rider.”<sup>250</sup>

177. The resulting S&F charges and volumetric rates are as follows:<sup>251</sup>

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<sup>248</sup> *Id.* at 11:1-8.

<sup>249</sup> *Id.* at 11:19-12:5.

<sup>250</sup> *Id.* at 12:21-13:1.

<sup>251</sup> Hearing Exhibit 103, Attach. GLS-2 (Direct Testimony of Mr. Smith).

	<u>Residential</u>		<u>Commercial</u>		<u>Irrigation</u>		<u>Transportation</u>	
	<u>Current</u>	<u>Proposed</u>	<u>Current</u>	<u>Proposed</u>	<u>Current</u>	<u>Proposed</u>	<u>Current</u>	<u>Proposed</u>
<b><u>S&amp;F Charge</u></b>	\$11.60	\$14.00	\$28.24	\$28.59	\$44.89	\$45.45	\$84.17	\$85.21
<b><u>Bottom-Line S&amp;F Charge</u></b> <sup>252</sup>	\$12.55	\$15.10	\$30.00	\$30.59	\$46.05	\$46.05	\$85.21	\$86.97
<b><u>Volumetric Rate</u></b> <sup>253</sup>	\$0.18648	\$0.36764	\$0.11023	\$0.18294	\$0.10241	\$0.16997	\$0.09115	\$0.15128
<b><u>Bottom-Line Volumetric Rate</u></b> <sup>254</sup>	\$0.31295	\$0.37867	\$0.18610	\$0.19987	\$0.16997	\$0.17348	\$0.15128	\$0.15440

178. Atmos contends that its proposed significant increase to the Residential class’ S&F charge “align[s] fixed charges with actual cost drivers.”<sup>255</sup> Further, “[a]ligning fixed rates more closely with the actual costs of providing service will benefit the State’s carbon reduction goals by providing more accurate price signals.”<sup>256</sup> According to Atmos, “recovery of fixed distribution system costs via fixed charges more accurately reflects the reality that most gas utility costs do not vary with usage.”<sup>257</sup>

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<sup>252</sup> The current charge includes TCJA, Percentage of Income Payment Plan (PIPP), Demand Side Management Cost Adjustment (DSM), and Energy Assistance System Benefit Charge (EASBC) charges. The proposed charge includes those charges plus charges for Rate Case Expense and Rate Case Refund of Excess Deferred Income Tax. See Hearing Exhibit 103, Attach. GLS-2 (Direct Testimony of Mr. Smith).

<sup>253</sup> The current rate does not include TCJA and SSIR charges, which are separately charged. The proposed rate includes the TCJA and SSIR charges rolled into the rate.

<sup>254</sup> The current rate includes TCJA, SSIR, and DSM charges. The proposed rate includes Rate Case Expense, Rate Case Refund of Excess Deferred Income Tax, and DSM charges. See Hearing Exhibit 103, Attach. GLS-2 (Direct Testimony of Mr. Smith).

<sup>255</sup> Atmos’ SOP at 22.

<sup>256</sup> *Id.*

<sup>257</sup> *Id.*

## 2. Intervenors

### a. Staff

179. As noted above, Staff recommends that the Commission reject Atmos' use of the MDS approach to allocating mains and maintain the S&F charge at its current level.<sup>258</sup>

### b. UCA

180. As noted above, UCA disagrees with the use of MDS and the resulting assignment of mains in Atmos' CCOSS. UCA revised Atmos' CCOSS by eliminating the customer classification for mains and re-classifying them to the demand cost category.<sup>259</sup> The results indicate that, contrary to Atmos' conclusion that the Residential Class is being subsidized by the Commercial, Irrigation, and Transportation Classes, it is the Residential Class that it is subsidizing the Non-Residential Classes, and to a substantial extent.<sup>260</sup> By assigning the entire revenue deficiency to the Residential Class, Atmos is thus proposing to increase the subsidization of the Non-Residential Classes by the Residential Class.<sup>261</sup>

181. UCA proposes to eliminate as much of the currently existing subsidies as possible. However, given the degree of current subsidization, UCA believes that eliminating all subsidies in this proceeding would result in rate shock for the Non-Residential Classes. UCA thus recommends the increase to any rate class be limited to 1.25 times Atmos' increase in revenue, whatever that turns out to be.<sup>262</sup> According to UCA, this multiplier "is a matter of judgment based on two criteria: (1) there should be meaningful movement toward cost-based rates; and (2) the resulting rate impact

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<sup>258</sup> Staff's SOP at 28.

<sup>259</sup> Hearing Exhibit 403 at 22:9-14 (Answer Testimony of Mr. Peterson).

<sup>260</sup> *Id.* at 20:15-21:7.

<sup>261</sup> *Id.* at 21:8-22:10.

<sup>262</sup> *Id.* at 23:1-11.

on the Commercial, Irrigation, and Transportation classes should be reasonable in light of all circumstances.”<sup>263</sup>

182. As to Atmos’ proposed S&F charges, UCA agrees that they are reasonable when compared to other Colorado utilities. For this reason, UCA does not object to them “so long as [they] . . . reflect a proportionate change equivalent to the actual final determination of each rate class’s change in [revenue requirement] responsibility upon the conclusion of this Proceeding.”<sup>264</sup>

**c. EOC**

183. EOC disagrees with Atmos’ proposed increase to the S&F charge for the Residential Class. According to EOC, such an increase has a disproportionate impact on income-qualified (IQ) households as it gives them less control over their bills. IQ households “often make the unwelcome choice of foregoing or reducing heating or the use of other utilities in order to afford their bill.”<sup>265</sup> EOC states that a higher S&F charge will harm IQ households.<sup>266</sup>

184. EOC also asserts that an increase to the S&F charge will hurt Colorado’s environmental goals. An increase will hurt Atmos’ DSM program by “making energy savings harder to achieve and increasing the payback period of DSM investment for customers.”<sup>267</sup> Such an outcome is contrary to “Colorado’s policies of reducing greenhouse gas emissions and incentivizing energy efficiency.”<sup>268</sup>

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<sup>263</sup> *Id.* at 23:11-14.

<sup>264</sup> Hearing Exhibit 22:5-8 (Answer Testimony of Dr. England).

<sup>265</sup> EOC SOP at 11-12.

<sup>266</sup> *Id.* at 13.

<sup>267</sup> *Id.*

<sup>268</sup> *Id.* at 14.

### 3. Analysis

185. The ALJ finds and concludes that it is in the public interest to keep the Residential S&F charge at its current level. As to the remainder of the rates, the ALJ will order Atmos to recalculate its overall revenue deficiency and to rerun its CCOSS consistent with this Decision. Atmos shall recalculate all components of base rates for the non-residential rate classes (*i.e.*, the S&F charge, the demand charge, and the volumetric charge, as necessary). Atmos shall also recalculate the volumetric Residential rate with S&F charge set at its current level. Atmos is authorized to design rates such that no class will be provided with a rate decrease and that, if a class is not providing sufficient revenues to cover its identified cost of service at proposed rate levels, required revenues will be increased for all deficient classes to a level that equalizes the return for those classes consistent with the identified cost of service in the CCOSS. If Atmos files Exceptions to this Recommended Decision, Atmos shall file workpapers that illustrate alternative mitigation approaches and rate designs that limit the base rate revenue increase to any rate class to 1.10, 1.15, 1.20, 1.25, and 1.30 times Atmos' overall increase in revenue.

## VII. GRSA

### A. Atmos

186. Atmos has proposed to recover rate case expense, pension amortization, and Excess Deferred Income Taxes (EDIT) via a General Rate Schedule Adjustment (GRSA). According to Atmos:

The GRSA is a more efficient means of recovering these reasonable operating expenses, as compared to base rates, as it allows [Atmos] to reflect actual costs and is more administratively efficient. Instead of waiting until a rate case to extinguish any of the fully amortized accounts or to address under- or over-recovery, Atmos [] can make the necessary

adjustments through targeted advice letter filings, consistent with the practice approved in Atmos Energy's 2015 and 2017 rate cases.<sup>269</sup>

Atmos accepts Staff's proposal to offset the over-recovery of pension/OPEB expense since the last rate case against the unamortized balance of the pension asset that was established in Proceeding No. 17AL-0429G. Accordingly, Atmos Energy will move the remaining pension amortization out of base rates and into the GRSA rate to efficiently adjust customer rates when the remaining pension asset. Atmos also agrees with Staff's and UCA's proposal for a three-year recovery period for rate case expense,<sup>270</sup> and with EOC's request that the GRSA be volumetric for the residential class.<sup>271</sup>

## **B. Intervenors**

### **1. Staff**

187. Staff agrees that the use of a GRSA to recover rate case expenses is appropriate, but recommends that recovery be over three years, instead of one.<sup>272</sup>

### **2. UCA**

188. UCA recommends that recovery of rate case expenses be through base rates, and not the GRSA, and that recovery should be over three years, not one.<sup>273</sup> UCA believes that segregating rate case expenses from the base rate revenue requirement creates a misleading picture of what Atmos proposed to charge its customers.<sup>274</sup>

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<sup>269</sup> Atmos SOP at 24.

<sup>270</sup> *Id.*

<sup>271</sup> Hearing Transcript at 89:22-90:4 (January 6, 2023).

<sup>272</sup> Hearing Exhibit 304, Rev. 1 at 16:11-16.

<sup>273</sup> Hearing Exhibit 400, Rev. 1 at 11:3-5, 6-12

<sup>274</sup> UCA's SOP at 26.

### 3. EOC

189. EOC asserts that a GRSA should not be used to recover these expenses because it creates a disincentive for a utility to file a subsequent rate case. However, “if the Commission is inclined to approve the use of a GRSA for this expense recovery, the Commission should order [Atmos] to recover such GRSA from residential customers on a volumetric basis only.”<sup>275</sup>

#### C. Analysis

190. The ALJ finds and concludes that Atmos has carried its burden of establishing that it is appropriate to recover rate case expense, pension amortization, and EDIT over three years through a GRSA that will be volumetric for the residential class.

## VIII. MISCELLANEOUS ISSUES

### A. Rendering Service

191. In its Direct Testimony, Atmos sought to eliminate its charges for “Rendering Services,” which are charges for instituting gas service, reinstating gas service, transferring service, driving to locations to complete the charges, final meter reading, and collection. Atmos “thought it would promote equity and assist disproportionately impacted communities by spreading these costs over all customers and recovering these charges through base rates.”<sup>276</sup> In its Rebuttal Testimony, Atmos reversed course in light of the intervenors’ opposition to such a move.<sup>277</sup> Atmos confirmed its reversal in its SOP.<sup>278</sup>

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<sup>275</sup> EOC’s SOP at 17.

<sup>276</sup> Hearing Exhibit 111 at 7:9-11 (Rebuttal Testimony of Mr. Armstrong).

<sup>277</sup> *Id.* at 8:6-10.

<sup>278</sup> Atmos’ SOP at 23.

192. Accordingly, Atmos' original proposal to eliminate Rendering Service charges will not be adopted. Atmos is authorized to maintain the charges at existing levels on Sheet No. 12, as the Company did not update the charges in the proceeding.<sup>279</sup>

**B. Quality of Service Plan**

**1. Staff**

193. Staff proposes a Quality of Service Plan (QSP) consisting of: (a) a requirement that Atmos be required to show that DI communities have a reliability of a least 0.99990; (b) a requirement that Atmos' annual average leak repair time for Grade 2 leaks be less than 54.0 days; (c) a requirement that Atmos inspect at least 9,000 customer-owned yard lines (COYLs) each year as part of its PHMSA required system inspections; and (d) a penalty of \$50,000 for each metric Atmos does not meet on an annual basis.<sup>280</sup>

194. As to the first proposed requirement, Staff states that "[g]iven the Commission's focus on DI communities, Atmos' has to evaluate service to DI communities in some fashion, and if there is another preferred path, Atmos could have raised it."<sup>281</sup> Staff further states that, while Atmos' average reliability to all ratepayers is 0.999962, it is reasonable to set the metric for purposes of the QSP to 0.99990.<sup>282</sup>

195. The second requirement – that Atmos' annual average leak repair time for Grade 2 leaks be less than 54.0 days – is Atmos' best performance over the last ten years.<sup>283</sup> Staff contends that it is proper to pick a performance level based on past experience, and then to expect

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<sup>279</sup> Hearing Exhibit 111 at 8:8 (Rebuttal Testimony of Mr. Armstrong).

<sup>280</sup> Staff's SOP at 29.

<sup>281</sup> *Id.*

<sup>282</sup> *Id.*

<sup>283</sup> *Id.* at 30.

and encourage improvement going forward.<sup>284</sup> Staff believes it is reasonable to expect Atmos to match its best performance on such a critical safety issue in the future.

196. As to the third requirement, “customers are not in a position to conduct the sort of safety examinations that Atmos could perform.”<sup>285</sup> Given the age of the COYLs, it makes sense for Atmos to undertake the inspections. Staff has not proposed that Atmos pay for any necessary repairs.

197. Finally, Staff argues that a penalty for violations of the QSP is necessary to incentivize compliance with the QSP.

## 2. Atmos

198. Atmos opposes the QSP Plan proposed by Staff for six primary reasons.

199. First, according to Atmos, Staff did not present evidence of problems with the quality of Atmos’ service that justify the imposition of a QSP.<sup>286</sup>

200. Second, there is no upside to the QSP for Atmos, which means that it “can only result in [Atmos] being penalized, likely depriving [Atmos] of a reasonable opportunity to achieve its awarded rate of return.”<sup>287</sup>

201. Third, the DI metric is “undeveloped, problematic, and unlikely to benefit DI communities.” Staff has not proposed a definition of DI communities and, even if it did, “it is generally problematic for [Atmos] to treat customers differently.” And the base performance metric of 0.99990 “does not provide [Atmos] with a real opportunity for improvement.”<sup>288</sup>

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<sup>284</sup> Hearing Transcript at 178:19-179:9 (January 10, 2023).

<sup>285</sup> Atmos’ SOP at 31.

<sup>286</sup> Atmos’ SOP at 26.

<sup>287</sup> *Id.*

<sup>288</sup> *Id.*

202. Fourth, the annual average leak repair time metric offers no real opportunity for improvement because it sets as the baseline for comparison Atmos' best performance over the last ten years. To avoid penalty, Atmos would be required to exceed its best performance over the last decade on an annual basis going forward. Atmos contends that Staff has provided no evidence of the reasonableness of this requirement.<sup>289</sup>

203. Fifth, the proposal for Atmos to inspect 9,000 COYLs each year is unworkable. COYLs are not part of Atmos' system. Yet, Staff asserts that Atmos' ratepayers should pay for any needed repairs, even those ratepayers who do not have COYLs. Staff has not analyzed how much it would cost for Atmos to take on this responsibility.<sup>290</sup>

204. Finally, the proposed penalty is unreasonable because it is "grossly oversized as compared to other Colorado utilities' QSP penalties."<sup>291</sup>

### 3. Analysis

205. The ALJ finds and concludes that Staff has not carried its burden of establishing that the QSP it has proposed is appropriate at this time. There simply are too many questions surrounding the proposed QSP concerning whether it would achieve its goal or have unintended consequences. Nevertheless, there is no credible dispute that a carefully crafted QSP would be valuable to Atmos and its ratepayers. Accordingly, the ALJ will direct Atmos to work with Staff to create a QSP.<sup>292</sup>

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<sup>289</sup> *Id.* at 26-27.

<sup>290</sup> Hearing Transcript at 176:10-177:5 (January 10, 2023).

<sup>291</sup> *Id.*

<sup>292</sup> *See* Decision No. R16-0058 issued in Proceeding No. 15A-0667G on January 22, 2016, at 35 (¶ 109) (ordering Black Hills Energy to work with Staff to create a QSP); Decision No. R18-0972 issued in Proceeding No. 18AL-0305G on November 1, 2018 (approving settlement agreement requiring Colorado Natural Gas to work with Staff to create a QSP).

**C. Line Extension Policy****1. Staff**

206. In Decision No. C22-0514-I, the Commission stated:

we encourage parties in this Proceeding to address and discuss the issues surrounding the Company's line extension policy and its associated construction allowances through testimony in the course of this Proceeding. We ask that Atmos, and the parties also speak to the necessary steps that the Company should take to update the Company's construction allowances and other provisions of its line extension policy to address the issues developed in this Proceeding.<sup>293</sup>

207. In its Answer Testimony, Staff made two recommendations regarding line extensions. First, Staff recommended that the Commission should require new customers to bear some portion of the upfront costs of meters and regulators. Second, Staff requested that the Commission order Atmos to file, at the conclusion of this Proceeding, a compliance advice letter modifying Construction Allowances such that each customer class's Construction Allowance is equal to the lower of (1) the net AEC methodology as applied to the test year, depreciation, and CCOSS approved in this Proceeding; or (2) the current Construction Allowance.<sup>294</sup>

**2. Atmos**

208. Atmos states that it should not be required to amend its line extension policy as part of this proceeding. The Commission recently proposed a new rule that requires utilities to provide updated line extension allowances in a base rate proceeding, or via a separate application, no later than December 31, 2024. Atmos says that it will comply with the Commission's rule once it becomes final, and it would be inefficient to require changes to the Company's line extensions in this proceeding under these circumstances.

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<sup>293</sup> C22-0514-I at 8 (¶ 29).

<sup>294</sup> Hearing Exhibit 303 at 17:4-18 (Answer Testimony of Mr. Haglund).

### 3. Analysis

209. The ALJ agrees with Atmos that it is inappropriate to address its line extension policy in this proceeding. The record simply does not provide the requisite support to make any changes to Atmos' existing line extension policy. In addition, as noted by Atmos, the Commission has adopted a new Rule 4210(d) that requires Atmos to update its line extension policy consistent with Rule 4210 such that the new policy will be "implemented no later than December 31, 2024." The new line extension policy must be proposed in a base rate proceeding if Atmos "utilizes standardized costs in calculating one or more portions of its line extension policies" or otherwise in an application. Under these circumstances, and given that the record in this proceeding is insufficient to support a revision to Atmos' existing line extension policy, the ALJ finds and concludes that it would not be in the public interest to adopt Staff's proposal.

#### D. Interruptible Service

210. Atmos does not currently offer Interruptible Service to its ratepayers and did not offer it when Winter Storm Uri occurred, which was an issue in the proceeding opened to address the costs incurred by Atmos during Winter Storm Uri (Proceeding No. 21A-0186G). In the Settlement Agreement in that proceeding, Atmos agreed to:

[c]onduct a stakeholder meeting before the Company's next general rate case filing and no later than April 29, 2022, to discuss interruptible services ("Interruptible Meeting"). Atmos Energy will report on the outcome of the Interruptible Meeting and will address those issues as it deems appropriate in its next general rate case filing in Colorado. All other Settling Parties will be free to make such recommendations as they deem appropriate regarding those issues in that rate case.<sup>295</sup>

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<sup>295</sup> Hearing Exhibit 104, Attach. JNG-1 at 7-8 (¶ 12) in Proceeding No. 21A-0186G.

211. Atmos distinguishes between two types of interruptible service: (a) interruptible transportation service; and (b) interruptible sales service. In interruptible transportation service, the customer supplies the gas and Atmos provides transportation of that gas to a point on Atmos' pipeline specified by the customer. In interruptible sales service, Atmos supplies both the gas and the transportation service. In both, the customers pay a discounted price for the interruptible service in exchange for giving Atmos the right to interrupt their service under certain circumstances. In interruptible sales service, "the discount is in the usage rate, and the customer still pay the full Gas Cost Adjustment ('GCA') charge. The Company does not buy separate gas for interruptible sales customers or run a separate GCA for them."<sup>296</sup>

212. Prior to filing this proceeding, Atmos held the stakeholder meeting required by the Settlement Agreement in Proceeding No. 21A-0186G.

### **1. Atmos**

213. Atmos argues that it is inappropriate to introduce interruptible service in this proceeding. Atmos does not believe that its "large volume Firm Transportation customers. . . would be willing to risk being interrupted during a prolonged period of cold temperatures, especially given the likelihood of such weather in Colorado."<sup>297</sup> As to interruptible sales service, while Atmos concedes that such service "can have an impact on customer has costs," "a significant number of customers would have to sign up" for such service "to have a meaningful impact on gas costs generally."<sup>298</sup> However, Atmos believes "that customers would be unwilling to pay the full

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<sup>296</sup> Hearing Exhibit 105 at 8:10-12 (Direct Testimony of Mr. Leivo).

<sup>297</sup> *Id.* at 6:23-7:2 (Direct Testimony of Mr. Leivo).

<sup>298</sup> *Id.* at 7:14-18.

GCA rate for interruptible sales gas, especially with the expectation that they could be interrupted multiple times each winter season due to cold weather.”<sup>299</sup>

214. Atmos concedes that introducing interruptible service would “provide additional customer choice, which . . . [is] a good thing.”<sup>300</sup> However, Atmos believes that the downsides to such an introduction outweigh the upsides. Those downsides are: (a) interruptible services can lead to more overall gas usage than would be available with firm services alone, which would lead to increased greenhouse gas emissions; and (b) some existing firm customers could switch to interruptible services in an attempt to save money, which would shift some portion of system costs to remaining firm service customers.<sup>301</sup>

215. Accordingly, Atmos does not propose to introduce interruptible service.

## 2. Staff

216. Staff disagrees with Atmos’ analysis for three primary reasons. First, Staff concludes that Atmos did not thoroughly assess the benefits of interruptible services: (a) during emergencies such as the Winter Storm Uri event; (b) in helping Colorado transition to a Clean Heat future; (c) in increasing customer choice; and (d) in increasing Atmos’ revenues.<sup>302</sup>

217. Second, other utilities in Colorado offer interruptible services. Colorado’s cold weather has not impeded those utilities from offering such services.<sup>303</sup>

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<sup>299</sup> *Id.* at 8:17-19.

<sup>300</sup> *Id.* at 10:3-4.

<sup>301</sup> *Id.* at 10:10-11:7.

<sup>302</sup> Hearing Exhibit 300, Rev. 1 at 93:6-11 (Answer Testimony of Ms. Ghebregziabher).

<sup>303</sup> *Id.* at 93:15-16.

218. Third, a significant interruptible sales load could help Atmos better manage its capacity load “during times of reliability, capacity, and/or economic emergency.” As support, Staff states:

interruptible services could be useful in areas where [Atmos] cannot support more firm service, as [Atmos] currently serves many communities at higher elevations where there is no available additional upstream capacity. Since there is no load study necessary for interruptible service, [Atmos] would provide the requested service and simply interrupt it when incapable of providing service. In other words, interruptible services could also allow [Atmos] to offer services in areas where there is no available additional upstream capacity without needing to expand its gas system – which in turn could help Atmos [] avoid increasing investments to expand its services while generating additional revenues from added customers.<sup>304</sup>

219. However, “Staff understands that providing the Commission with a well-developed interruptible service(s) may not be feasible in this current rate filing.” For this reason, Staff recommends that the Commission direct Atmos to: (a) “thoroughly assess the benefits of interruptible services in Colorado through surveys and/or assessments of similar programs in Colorado or in its other jurisdictions;” and (b) “develop interruptible services that take into consideration natural disasters, gas prices, environmental concerns, and customer choice.”<sup>305</sup> Staff requests that Atmos be required to present this information “in the next gas rate case filing or in the appropriate Phase II filing.”<sup>306</sup>

### 3. Analysis

220. The ALJ agrees with Staff that the record in this proceeding is insufficient to support any decision on whether it is appropriate for Atmos to introduce interruptible service(s). The ALJ also agrees that such services could be beneficial to both Atmos and its ratepayers.

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<sup>304</sup> *Id.* at 94:6-16.

<sup>305</sup> *Id.* at 95:1-15.

<sup>306</sup> *Id.* at 95:16-17.

Accordingly, the ALJ will require Atmos to: (a) thoroughly assess the benefits of interruptible services in Colorado through surveys and assessments of similar programs in Colorado or in Atmos' other jurisdictions; (b) develop interruptible services that take into consideration natural disasters, gas prices, environmental concerns, and customer choice; and (c) present such information in Atmos' next gas rate case filing or in another appropriate filing, whichever is earlier.

## **E. Enhanced Leak Surveillance Measures**

### **1. Staff**

221. Staff requests that Atmos be ordered to either implement, or explain why it should not implement, enhanced leak surveillance measures designed to improve public safety and advance environmental justice in its Colorado service territory. Staff states that “[a]n explanation of such measures should include, but not be limited to, applying three-year intervals between leak surveys and gradually including COYLs in periodic leak surveillance programs.”<sup>307</sup> Staff states that such measures are necessary “given the quantity of pipes made of vintage bare steel and PVC located in its service territory.”<sup>308</sup>

### **2. Atmos**

222. Atmos states that it is already implementing an enhanced leak surveillance measure designed to improve public safety and reduce carbon emissions. As a result, Staff's proposal for additional enhanced leak surveillance measures is unnecessary. Even if it were not, Atmos states that Staff's proposal is too vague to implement.

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<sup>307</sup> Hearing Exhibit 306 at 8:13-15 (Answer Testimony of Ms. Ramos).

<sup>308</sup> *Id.* at 43:5-7.

### 3. Analysis

223. The ALJ finds and concludes that Staff has not satisfied its burden of establishing that Atmos must implement enhanced leak detection measures. Atmos has established that it has already implemented such measures. The ALJ also agrees with Atmos that Staff's request is too vague to be implemented.

#### F. Miscellaneous Tariff Revisions

##### 1. Atmos

224. Atmos has proposed tariff changes to: (a) correct percentages stated in the EFM Imbalance Provisions of its tariff; and (b) eliminate tariff sheets sheet Nos. 9-11.

##### 2. Intervenors

225. No intervenor disputed these tariff changes proposed by Atmos.

##### 3. Analysis

226. The ALJ finds and concludes that the proposed changes are reasonable and will improve administrative efficiency. Accordingly, they will be adopted.

#### IX. RECOMMENDED DECISION

227. In accordance with § 40-6-109, C.R.S., it is recommended that the Commission enter the following Order.

#### X. ORDER

##### A. The Commission Orders That:

1. The effective date of the tariff sheets filed by Atmos Energy Corporation (Atmos) with Advice Letter No. 584 on August 5, 2022, is permanently suspended and shall not be further amended.

2. The tariff sheets filed by Atmos with Advice Letter No. 584 are permanently suspended and shall not be further amended.

3. Proceeding No. 22AL-0348G is closed.

4. No later than five calendar days after this Recommended Decision becomes the Decision of the Commission, if that is the case, Atmos shall file a new advice letter and tariffs on not less than 14 calendar days' notice in order to place the compliance tariff sheets P.U.C. No. 7 Tariff into effect, consistent with the findings, discussion, and conclusions in this Decision. The advice letter and tariff shall be filed as a new advice letter proceeding and shall comply with all applicable Commission rules. In calculating the proposed effective date, the date the filing is received at the Commission is not included in the notice period and the entire notice period must expire prior to the effective date. The advice letter and tariffs must comply in all substantive respects to this Decision in order to be filed as a compliance filing on shortened notice.

5. As provided by § 40-6-109, C.R.S., copies of this Recommended Decision shall be served upon the parties, who may file exceptions to it.

a) If no exceptions are filed within 20 days after service or within any extended period of time authorized, or unless the decision is stayed by the Commission upon its own motion, the Recommended Decision shall become the decision of the Commission and subject to the provisions of § 40-6-114, C.R.S.

b) If a party seeks to amend, modify, annul, or reverse basic findings of fact in its exceptions, that party must request and pay for a transcript to be filed, or the parties may stipulate to portions of the transcript according to the procedure stated in § 40-6-113, C.R.S. If no transcript or stipulation is filed, the Commission is bound by the facts set out by the administrative law judge and the parties cannot challenge these facts. This will limit what the Commission can review if exceptions are filed.

6. Response time to any exceptions that may be filed is shortened to seven (7) days.

7. If exceptions to this Decision are filed, they shall not exceed 30 pages in length, unless the Commission for good cause shown permits this limit to be exceeded.

8. If Atmos files exceptions, it shall file with its exceptions an updated revenue requirement, updated class cost of service studies, updated GRSA calculations, and corresponding bill impacts. The updates must reflect the decisions made in this Decision. In addition, Atmos shall file tariff filing workpapers that illustrate alternative mitigation approaches and rate designs that provide results with a limit to the base rate revenue increase to any rate class of to 1.10, 1.15, 1.20, 1.25, and 1.30 times Atmos' overall increase in revenue.

(S E A L)



THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF COLORADO

CONOR F. FARLEY

\_\_\_\_\_  
Administrative Law Judge

ATTEST: A TRUE COPY

A handwritten signature in black ink, appearing to read "G. Harris Adams".

G. Harris Adams,  
Interim Director