

FREQUENTLY ASKED QUESTIONS REGARDING ACSC HISTORY AND THE RRM RATEMAKING PROCESS

What is the role of Cities in ratemaking?

Cities have historically exercised original jurisdiction over the level of gas rates charged within their boundaries. Generally, gas distribution utilities have filed rate cases at the City level and have only gone to the Railroad Commission of Texas (“RCT” or “Commission”) with an appeal of City action or when they could not reach a settlement with Cities. If a utility and Cities reach an agreement, the utility may then file a case at the RCT to implement the same rates approved by Cities in areas outside municipal boundaries.

Once a case is at the RCT, the Commission Staff generally expects Cities to intervene and do most of the discovery, cross-examination, briefing, and sponsor opposing witnesses. There is no consumer advocate at the RCT. If Cities do not participate in hearings at the RCT, the request of a regulated utility is likely to be rubber-stamped.

How and why was the Atmos Cities Steering Committee created?

The Atmos pipeline and distribution systems were built, owned, and operated by Lone Star Gas (“LSG”), which maintained over 200 rate jurisdictions until it sold its assets to Texas Utilities (“TXU”) in the late 1990’s. That meant that many Cities had their own unique distribution rates and that individual Cities had to process rate cases at the local level. LSG-Pipeline served all 200-plus distribution systems, and pipeline rates were set by the RCT.

From the early 1980’s through the late 1990’s, LSG filed no pipeline or system-wide rate cases at the RCT. When LSG was finally brought before the RCT to show cause why its rates should not be reduced, approximately 80 Cities intervened and created an *ad hoc* group known as the Steering Committee of Cities Served by Lone Star. In Gas Utilities Division (“GUD”) docket number 8664, three separate groups of Cities and a number of independent Cities (jointly the “Aligned Cities”) participated and coordinated their efforts to oppose the rate increase.

TXU purchased the LSG assets in the late 1990’s and immediately commenced consolidating 200-plus ratemaking jurisdictions into regions. As regional cases were filed, Cities within each region created an *ad hoc* committee to form a common strategy and negotiating position. Once TXU had aggregated the Cities into five or six jurisdictions, each with a different rate, Texas Utilities Gas Company filed a system-wide case to bring all of the old LSG territory under one common rate. The different City regional committees then united and formed the Allied Coalition of Cities (“ACC”). While the gas utility assets were owned and controlled by TXU, the coalition transformed itself from an *ad hoc* group that came together only in response to rate filings by the utility into a permanent standing coalition.

In Gas Utilities Docket (“GUD”) No. 9400 in 2004, TXU’s request for a \$61.6 million system-wide increase was aggressively opposed by ACC. Cities achieved disallowances of \$42.9 million of a regulatory asset and \$87.8 million of capitalized gas utility plant. The company received only a \$2.01 million increase. Unhappy with that result, TXU decided that owning a gas system was neither as fun nor as profitable as the deregulated electric system, and they sold the system to Atmos Energy Corporation (“Atmos” or “Company”). ACC was then transformed into the Steering Committee of

Cities Served by Atmos and then renamed Atmos Cities Steering Committee to obtain an easy to remember acronym, “ACSC.”

What is the Atmos Cities Steering Committee?

ACSC is a coalition of 170 Cities that unite in common purpose to address gas utility rate and franchise issues related to Atmos Energy Corporation. Its objectives are to: (1) ensure that gas utility rates charged to Cities and their residents are fair and reasonable; (2) maintain reasonable franchise fee revenues for Cities; (3) protect Cities’ original jurisdiction over rates and services; (4) be a voice for consumers where no state agency assumes such a role; and (5) promote sound ratemaking policies in the public interest.

Cities join the permanent standing committee by passing a resolution and agreeing to support the work of ACSC through modest occasional *per capita* assessments that support ongoing administrative and legislative advocacy and all expenses where Cities are not entitled to reimbursement. Each member City designates a representative to ACSC. Member representatives may volunteer to serve on the ACSC Executive Committee. The Executive Committee sets policy, hires legal counsel and consultants, directs litigation, establishes a legislative agenda, sets assessments on members as needed, and meets quarterly with Atmos executives. The Settlement Committee is directly involved in negotiating resolution of contested matters with Atmos executives. The list of current members is attached.

What is the benefit of membership in ACSC?

One hundred seventy Cities speaking as one voice is much more effective in advocacy before the Railroad Commission and legislature than any one City or multiple small groups of Cities.

The legislature has given gas utilities a right to an annual increase in rates. Resources (both financial and human) of individual Cities are conserved by membership in ACSC. Additionally, membership enhances institutional memory of ratemaking issues, public policy debates, and right-of-way and franchise fee battles.

What has ACSC accomplished?

Going into the 82nd Legislative Session, in December 2010, ACSC released a 48-page report, “Natural Gas Consumers and the Texas Railroad Commission.” More than 200 television, newspaper and radio news sites posted information on, and a link to, the report that may be found on ACSC’s website, TexasGasConsumers.org.

ACSC has also been instrumental in ongoing Sunset Commission reviews of the RCT. The agency has undergone three Sunset reviews since 2010, and in each case ACSC has maintained a watchful eye on the process to ensure that provisions that could harm the interest of gas utility ratepayers are excluded from the legislation. ACSC representatives also visited on several occasions with the Sunset Commission Staff, and several ACSC recommendations for reform were included in Sunset Commission Reports on the agency. Several ACSC member representatives testified before the legislature regarding the Sunset review of the Railroad Commission.

During the 2011 legislative session, lobbying efforts by ACSC were critical in killing two gas utility bills that would have undermined traditional regulation, deprived Cities of certain rights, and led to even greater rate increases.

ACSC has also resolved a major issue involving franchise fees. In 2010, Atmos unilaterally, without notice, ceased inclusion of franchise fees in the calculations of gross receipts regardless of whether specific franchises included such payments. Several Cities were willing to pursue the matter through litigation. However, counsel for ACSC was able to negotiate a resolution that allowed each member City to determine whether it desired an increase in franchise fee payments based on inclusion of franchise fees in the calculation of gross receipts. If a City opted for inclusion of fee-on-fee revenues, it had the further option of retroactive payments back to the point in time that Atmos decided to curtail fee-on-fee payments. Each member had these options regardless of the wording of the then-valid franchise agreement. This resolution spared significant litigation costs and anxiety and was only possible because of the clout of the ACSC membership.

One of the most significant accomplishments of ACSC occurred in 2007 via a settlement of the then-pending, system-wide rate case. Approximately 50 ACSC City representatives showed up in Arlington for a meeting with Atmos executives who were shocked at the vocal opposition to Atmos' practices, the unfairness of annual Gas Reliability Infrastructure Program ("GRIP") rate filings that precluded City and citizen review, and the Company's lack of coordination with Cities. That meeting led to the creation of the Rate Review Mechanism ("RRM") process and improved ongoing communications between the Company and ACSC.

In 2010, these improved communications between ACSC and the Company led to a workable solution to the need to replace steel service lines in a manner that accommodated Cities' needs to control their rights-of-way, while moderating the rate impact and focusing first on the riskiest service lines based on leak repair histories. This compromise precluded a more onerous (from a City and consumer perspective) program threatened by the RCT.

What is an RRM case?

The concept of an RRM proceeding emerged as a three-year experimental substitute for GRIP cases as part of the settlement of Atmos Mid-Tex's 2007 system-wide rate case. In 2003, the Texas Legislature added Section 104.301, Interim Adjustment for Changes in Investment, to the Gas Utility Regulatory Act. While not identified as such in the law, § 104.301 was referred to as the Gas Reliability Infrastructure Program or GRIP. The GRIP adjustments allowed gas companies to recover changes to invested capital without a review of whether increased revenues or declining expenses offset the invested capital costs. Both Atmos Pipeline and Atmos Mid-Tex filed GRIP cases as soon as the RCT adopted rules to implement the interim adjustments. As explained below, it quickly became apparent that the GRIP adjustments were terrible public policy.

As an alternative to GRIP, ACSC entered into a negotiated agreement with Atmos in 2007 to establish the RRM process. Unlike GRIP, the RRM provided for an annual review of all portions of Mid-Tex's cost of service. It fixed an authorized rate of return on equity for the three-year period at 9.6% (which was less than what the RCT would have authorized) and set caps on the extent to which expenses or investments could increase from one year to the next. More importantly, it allowed Cities to make a comprehensive evaluation of all aspects of the utility's business—investment, operation and maintenance expenses, and revenues—unlike GRIP that only allows consideration of changes to invested capital.

Why is RRM superior to GRIP?

GRIP cases guarantee a one-sided, rubber-stamp approval of the utility's rate request. ACSC attempted to participate in the first two GRIP proceedings filed by both Atmos Pipeline and Atmos Mid-Tex at the RCT. Not only were Cities' motions to intervene denied, but also, ACSC's comments were ignored. At the City level, ACSC consultants determined that Atmos was not only including items such as artwork, chairs, computers, and meals in interim rate adjustments that were allegedly intended to promote pipeline safety, but the Company was also over-earning its previously authorized rate of return. ACSC attacked the Commission's rule in court because it denied City participation, denied a hearing on a contested matter, and denied Cities' recovery of any expenses associated with resisting GRIP rate increases. The courts were not helpful to Cities. In 2011, the Texas Supreme Court upheld the Commission's rule implementing the GRIP statute.

Cities have contended that the GRIP process is terrible public policy since it authorizes what would, from the perspective of a history of public interest regulation, be regarded as unlawful—piecemeal ratemaking. GRIP allows rates to increase if the utility's invested capital net of depreciation increases year-over-year. An increase in rates is mandated under GRIP if investment increases, even if increasing revenues and declining expenses more than offset the costs associated with increased investment.

The RRM process negotiated by ACSC solves the piecemeal ratemaking problem by providing for a comprehensive review of Atmos' expenses and revenues. Furthermore, the RRM process benefitted ACSC by: (1) allowing Cities' participation that would be denied under GRIP; (2) allowing Cities to recover, at utility shareholders' expense, all their ratemaking costs; and (3) avoiding both litigation and RCT jurisdiction.

The legislature has functionally authorized annual increases in gas utility rates through the GRIP process. Since consumers are otherwise stuck with annual rate increases, it is better to have Cities participate in the comprehensive RRM process than be unable to participate in a piecemeal process.

What has been the history of the RRM efforts?

A total of eleven RRM filings have been made by the Company. These filings all resulted in settlements at the City level, except for the 2014 filing, which the ACSC Cities denied. The Company appealed the denial to the RCT, and ACSC was ultimately able to settle that proceeding before it reached the stage of a final RCT order. The results of these filings from a system-wide perspective are as follows (continued on next page):

RRM Filing	Year	Atmos Request	ACSC Settlement
#1	2008	\$33.5 million	\$20 million
#2	2009	\$20.2 million	\$2.6 million
#3	2010	\$70.2 million	\$27 million
#4	2011	\$15.7 million	\$6.6 million
#5	2013	\$22.7 million	\$16.6 million
#6	2014	\$45.7 million	\$43.8 million
#7	2015	\$28.8 million	\$22.8 million
#8	2016	\$35.4 million	\$29.6 million
#9	2017	57.4 million	\$48 million

RRM Filing	Year	Atmos Request	ACSC Settlement
#10	2018	\$27.4 million	\$24.9 million
#11	2019	\$54 million	\$35.4 million

Unable to reach agreement to perpetuate the original RRM terms, Atmos filed a traditional rate case with Cities in 2012 (GUD No. 10170), which was then appealed to the Railroad Commission. A final order in that case was entered in December 2012. The ratemaking decisions of the Commission then became the basis of renewal negotiations on the RRM process. The renewed RRM included some modifications that enhanced the original RRM process. Among these modifications were:

- A limit on the percentage of increase to be included in the monthly customer charge;
- A prohibition against capital post-test year adjustments;
- A time limit for known and measurable adjustments to operating and maintenance expenses;
- A guaranteed reduction in the Company’s requested increase of at least \$3 million annually; and
- A limitation on the amount of equity in the Company’s capital structure.

Changes to the RRM process

As noted in a communication to ACSC in May 2017, the rate of return on equity (“ROE”) embedded in the RRM process between 2013 and 2017 of 10.5% is excessive by at least 100 basis points, based upon a reasonable rate of return that reflects the market conditions in which the Company, and its parent Atmos Energy, operates. Because this ROE cannot be altered except by (1) changing the terms of the RRM tariff, or (2) a Commission order coming out of a new rate case, ACSC informed the Company that the 2017 RRM will be the last filing by the Company under the current tariff. Atmos agreed to renegotiate the terms and conditions of a revised RRM tariff in 2017.

In February and March 2018, ACSC adopted a new RRM tariff ordinance that implemented new procedures and criteria for the RRM process. The revised RRM tariff reduced the allowed ROE from 10.5% to 9.8% and captured the reduced federal income tax rate of 21%. The new tariff expanded Cities’ review period from three months to five months. It also required Atmos Mid-Tex to accept ACSC’s position regarding incentive compensation related to Atmos’ Shared Services Unit. The 2019 RRM filing is the second under the new tariff.

When must Cities approve new rates?

ACSC’s Tariff Ordinance adopted around March 2018 declares that new rates become effective October 1st of each year. While it is preferable that ordinances or resolutions adopting new tariffs are passed before the end of September, there is no adverse consequence if final action cannot take place until sometime in October. The only thing that will frustrate new rates becoming effective on October 1, 2019 is City action that specifically denies the increase.

What would happen if a City Council denies the RRM rate increase?

Atmos would either appeal the denial to the Railroad Commission or initiate imposition of GRIP rates or both. Rates for residents of that City would be higher than rates of other ACSC member residents. Rate case expenses (both the City and Company) associated with litigation at the Railroad Commission would likely be surcharged back to the City that denied the increase.

If you have other questions please contact me at (512) 322-5875 and/or gmg@lglawfirm.com, or Georgia Crump at (512) 322-5832 and/or gcrump@lglawfirm.com.

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