

Memorandum



CITY OF DALLAS

DATE: April 1, 2016

TO: Honorable Members of the Budget, Finance & Audit Committee –
Jennifer S. Gates (Chair); Philip T. Kingston (Vice Chair);
Deputy Mayor Pro Tem Erik Wilson; Rickey D. Callahan;
Scott Griggs; Lee M. Kleinman

SUBJECT: Presentation to the Budget, Finance & Audit Committee:
Atmos Energy Franchise Fee Audit

In conjunction with the Office of Financial Services, we will provide a briefing to the members of the Budget, Finance & Audit Committee on Monday, April 4, 2016 regarding:

- Budget, Finance & Audit Committee:
Atmos Energy Franchise Fee Audit

Sincerely,

A handwritten signature in black ink that reads "Craig D. Kinton".

Craig D. Kinton
City Auditor

C: Jeanne Chipperfield, Chief Financial Officer
Jack Ireland, Director – Office of Financial Services
Don Knight, Assistant City Attorney
Nick Fehrenbach, Manager of Regulatory Affairs – Office of Financial Services

Budget, Finance & Audit Committee

Atmos Energy Franchise Fee Audit



City of Dallas
April 4, 2016

Atmos Energy Franchise Fee Audit

- ▶ The City of Dallas (City) contracted with MuniServices, LLC in March 2014 to provide franchise fee compliance and recovery services from franchisees that provide natural gas, electricity, cable or video, and certificated telephone services to citizens of the City
- ▶ On October 5, 2015, MuniServices issued its Report of Examination to Atmos Energy Corporation (Atmos) for the examination period July 1, 2011 through June 30, 2014

Atmos Energy Franchise Fee Audit

According to MuniServices:

- ▶ Atmos paid the City a total of \$34,628,786 during the examination period
- ▶ Atmos owes the City an additional \$1,737,057, comprised of \$1,554,955 in franchise fees plus \$182,102 interest accrued as of October 5, 2015
- ▶ Additional franchise fees owed to the City are the result of Atmos' exclusion of franchise fees collected from customers in its calculation of Gross Revenues

Atmos Energy Franchise Fee Audit

- ▶ MuniServices requested that Atmos review the Report of Examination and *“either remit a payment for the underreported amount, or provide documentation to substantiate their position”* by November 2, 2015
- ▶ Having not received a response, on January 25, 2016 MuniServices issued a demand for payment letter
- ▶ On February 18, 2016, Atmos responded that the agreement between Atmos and the City does not require the inclusion of monies collected to recover franchise fees in the definition of Gross Revenues on which those franchise fees are paid

Atmos Energy Franchise Fee Audit

Atmos further stated:

- ▶ A willingness to allow the City to amend the definition of Gross Revenues to include fees collected pursuant to the Agreement, as well as remit an amount in settlement of past periods
- ▶ It would require that any such settlement bridge the entire time period from execution of the franchise agreement to the present and not include interest
- ▶ All sums paid to the City would be recovered from Atmos customers within the City
- ▶ Atmos would require the City to formally amend the Agreement to clearly reflect the City's intention that amounts collected to recover franchise fees paid to the City are included in the Gross Revenues on which those amounts are calculated

Atmos Energy Franchise Fee Audit

- ▶ MuniServices argues that the Ordinance imposes the franchise fee on the franchisee (Atmos) and therefore any monies collected from customers to recover the fee do not fall under the Section 14(a)(7)(b) exclusion from gross revenues *of “taxes or fees imposed by law on customers that Grantee is obligated to collect or authorized to recover and which Grantee passes on, in full, to the applicable governmental authority or authorities” (emphasis added)*
- ▶ MuniServices continues to assert that Atmos underpaid franchise fees to the City for the examination period

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► RECOMMENDATION

The Office of the City Auditor recommended that the City Manager work with Atmos, in consultation with the City Attorney, to resolve this dispute and to collect any additional monies ultimately determined to be owed to the City by Atmos related to the examination period.

Atmos Energy Franchise Fee Audit

MANAGEMENT RESPONSE

- ▶ City staff has reviewed the audit report, conferred with the City Attorney's Office, and met with Atmos to resolve this dispute
- ▶ City staff seeks City Council approval of a franchise amendment to clarify the definition of gross revenues:
 - To include franchise fees billed to customers in gross revenues; or
 - To exclude franchise fees billed to customers from gross revenues

Atmos Energy Franchise Fee Audit

- ▶ The dispute centers around the definition of “*Gross Revenues*” as intended by the franchise and what revenues are excluded from the calculation of franchise fees

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- ▶ The franchise requires Atmos to pay 5% of “*Gross Revenues*” as compensation to the City
 - Franchise fees are payments for use of the City’s ROW and are not taxes imposed on end use customers
 - Atmos chooses to pass franchise fees on to customers as a separate line item on their bill

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- ▶ MuniServices determined that franchise fees billed to customers should be included in Gross Revenue
- ▶ Atmos contends that franchise fees billed to customers are excluded from gross revenues as defined by the franchise
- ▶ As a result of the dispute, the franchise should be amended to clarify the issue of franchise fees inclusion or exclusion in the definition of gross revenues

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- ▶ If the City amends the franchise to clarify that franchise fees billed to customers are included in gross revenues, Atmos has agreed to pay the additional fees retroactively to the inception of the franchise (January 1, 2010)
 - One time payment of \$3,204,002
 - Increased franchise fees going forward (approximately \$600,000 annually)

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- ▶ Franchise fees paid by Atmos are automatically passed on to customers through Rate Rider FF
 - One time payment of \$3,204,002 will be recovered from customers over 12 months
 - ❑ Customers' bills will temporarily increase by 1.529% for 12 months, then drop to a 0.26% increase
 - ❑ Typical residential bill will increase by \$0.89 from \$58.36 to \$59.25 during the temporary 12 month period

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- ▶ Franchise fees paid by Atmos are forecast to be below budget for the current year
 - Warmer than normal weather this winter has resulted in less gas being used for heating
 - Staff is still working on quantifying the shortfall and will provide a revised forecast later in April
 - One time payment of \$3,204,002 will help offset the reduction in franchise fees caused by the weather

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OPTIONS

- 1) Amend franchise to clarify that franchise fees billed to customers are included in gross revenues
 - ▶ City to receive one time payment of \$3.2 million
 - ▶ Increased franchise fees going forward (approximately \$0.6 million annually)

- 2) Amend franchise to clarify that franchise fees billed to customers are excluded from gross revenues
 - ▶ No additional franchise fees due the City

CITY MANAGER'S RECOMENDATION

- ▶ Option 1: Amend franchise to clarify that franchise fees are included in gross revenues consistent with the gross revenue definition in other franchises

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WHAT'S NEXT

- ▶ April 13, 2016 Addendum will include an agenda item to adopt an ordinance amending the franchise to clarify either inclusion or exclusion of franchise fees from the definition of gross revenues based on the Committee's recommendation

QUESTIONS?



City of Dallas
April 4, 2016