



Delta Natural Gas Company, Inc.

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January 20, 2006

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JAN 23 2006

PUBLIC SERVICE
COMMISSION

Beth O'Donnell
Executive Director
Public Service Commission
P. O. Box 615
Frankfort, KY 40602-0615

RE: Case No. 2005-00547

Dear Ms. O'Donnell:

Enclosed are the original and six copies of the responses to the Commission Staff's Initial Data Request in the above-styled case.

Please acknowledge receipt of this filing by stamping the extra copy of the cover letter and returning to Delta in the envelope provided.

Sincerely,

Connie King
Director – Rates & Treasury

copy: Office of Attorney General
1024 Capital Center Drive
Suite 200
Frankfort, KY 40601-8204

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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PUBLIC SERVICE
COMMISSION

In the Matter of:

NOTICE OF PURCHASED GAS)
ADJUSTMENT FILING OF DELTA) CASE NO. 2005-00547
NATURAL GAS COMPANY, INC.)

INITIAL DATA REQUEST OF COMMISSION STAFF
TO DELTA NATURAL GAS COMPANY, INC.

1. Refer to Schedule IV of Delta's application, which shows the calculation of its actual adjustment. Delta has experienced periodic spikes in its per unit book cost of gas in prior purchased gas adjustment filings. However, the magnitude of the spikes in the current application appears to be greater than in the past.

a. For each month, August, September and October of 2005, explain in detail why the per unit book cost of gas was \$25.58, \$20.28 and \$73.67, respectively.

RESPONSE:

The primary reason why Delta's per unit cost of gas periodically spikes is because the supply volumes are recorded on a calendar month basis and the jurisdictional sales volumes are recorded on a billed month basis.

The secondary reason for the periodic spikes was the increase in supply costs. Wholesale natural gas prices increased 82% from August to October 2005.

In August 2005, the supply volume per books was 168,539 Mcf at a supply cost per books of \$1,510,804 or \$8.96 per Mcf. The NYMEX close for August 2005 was \$7.647. When the total supply cost per books of \$1,510,804 is spread over the jurisdictional sales volume of 59,061 Mcf for the billed month, the unit book cost of gas is \$25.5804 per Mcf.

In September 2005, the supply volume per books was 109,489 Mcf at a supply cost per books of \$1,448,262 or \$13.23 per Mcf. The NYMEX close for September 2005 was \$10.847; a 42% increase from August. When the total supply cost per books of

\$1,448,262 is spread over the jurisdictional sales volume of 71,403 Mcf for the billed month, the unit book cost of gas is \$20.2829 per Mcf.

In October 2005, the supply volume per books was 295,655 Mcf at a supply cost per books of \$4,721,546 or \$15.97 per Mcf. The NYMEX close for October 2005 was 13.907; a 28% increase from September and an 82% increase from August. When the total supply cost per books of \$4,721,546 is spread over the jurisdictional sales volume of 64,091 Mcf for the billed month, the unit book cost of gas is \$73.6694 per Mcf.

SPONSORING WITNESS:

Brian Ramsey

b. Is Delta aware of any means by which these spikes in its per unit book cost of gas could be minimized? Explain the response.

RESPONSE:

As explained in response 1a, the calculation of the Actual Adjustment in Delta's GCR mechanism is computed by dividing the dollars paid for gas supply in a calendar month by the volumes billed in that month, then comparing that to the EGC rate billed. This method inherently creates "spikes" or "dips" in the per unit book cost of gas. The volumes that Delta purchases in a calendar month can vary significantly from the volumes in a billing cycle billed in that month.

The reason the calculation was designed this way was due to the fact that these pieces of information used are the only "actual" pieces of information available. Working with "actual" gas cost that ties back into the books and "actual" Mcf sold, which ties back to our statistics reports, has made it simple over the years for management, external auditors, and the PSC to review the calculation for accuracy. The primary goal of this mechanism is to accurately compute the Actual Adjustment in a way that all parties know that it is truly working as a "dollar-tracker" mechanism and that gas costs are flowing through correctly to the customers.

Recognizing that this design would result in unusual "spikes" and "dips", actual adjustments are spread over a twelve month period, helping to minimize the impact on the customer. Generally speaking, this has worked quite well. The average AA over the last 12 GCR filings has been \$1.3609. In only one of the last 12 filings has the AA deviated from the average by over \$1. This most recent filing is the largest, at \$2.61, or \$1.25 above the average, but that is reasonable based on the movement of national gas prices, as discussed in response 1a.

If the conclusion is reached that this present level of volatility is unacceptable, some alternatives to consider include:

1) Further lengthening the period over which actual adjustments are amortized. This would reduce volatility, but would increase the lag time for recovery of costs. Given the environment of rising rates over the last several years, Delta has been consistently carrying large unrecovered gas cost balances. This situation would only worsen if the mechanism is changed in this way, and we suggest that we should be allowed to recover carrying costs to help offset this.

2) Instead of using the "actual" data for gas costs, begin using an "estimate" that coincides with the billing cycle. The disadvantage is a loss of the ability to tie gas cost per the GCR calculation directly into the books and controls/relationships that management, external auditors and PSC have relied on to ensure the integrity of the calculation would not be valid. This would add complexity to the calculation which in turn would increase the likelihood of errors and we do not recommend this.

SPONSORING WITNESS:

John B. Brown