DELTA NATURAL GAS COMPANY, INC.

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MAR 28 2017
PUBLIC SERVICE COMMISSION

March 28, 2017

Ms. Talina Mathews
Executive Director
Kentucky Public Service Commission
P O Box 615
Frankfort, KY 40602

RE: AN ADJUSTMENT OF THE PIPE REPLACEMENT PROGRAM RIDER OF DELTA NATURAL GAS COMPANY, INC.
Case No. 2017-00111

Dear Ms. Mathews,

Enclosed are the original and ten (10) copies of the responses to the Commission's Information Request dated March 20, 2017 in the above-styled case.

Please indicate receipt of this filing by date stamping the enclosed duplicate of this letter.

Sincerely,

Jenny Lowery Croft

Jenny Lowery Croft
Manager –Employee & Regulatory Services

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN ADJUSTMENT OF THE PIPE REPLACEMENT PROGRAM RIDER OF DELTA NATURAL GAS COMPANY, INC.	)))	**CASE NO. 2017-00111**

VERIFICATION

The undersigned, **John B. Brown**, being duly sworn, deposes and states that he is Chief Operating Officer, Treasurer and Secretary of Delta Natural Gas Company, Inc. and that he has personal knowledge of the matters set forth in the responses for which he is identified as the witness, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

John B. Brown

STATE OF KENTUCKY)
)
COUNTY OF CLARK)

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 27th day of March, 2017.

Notary Public (SEAL)

My Commission Expires:

6/20/20

Emily P. Bennett
Notary Public, ID No. 558362
State at Large, Kentucky
My Commission Expires on June 20, 2020

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN ADJUSTMENT OF THE PIPE REPLACEMENT PROGRAM RIDER OF DELTA NATURAL GAS COMPANY, INC.	)))	**CASE NO. 2017-00111**

VERIFICATION

The undersigned, **Matthew D. Wesolosky**, being duly sworn, deposes and states that he is Vice President – Controller of Delta Natural Gas Company, Inc. and that he has personal knowledge of the matters set forth in the responses for which he is identified as the witness, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

Matthew D. Wesolosky

STATE OF KENTUCKY)
)
COUNTY OF CLARK)

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 27th day of March, 2017.

Emily P. Bennett (SEAL)
Notary Public

My Commission Expires:

6/20/20

Emily P. Bennett
Notary Public, ID No. 558362
State at Large, Kentucky
My Commission Expires on June 20, 2020

DELTA NATURAL GAS COMPANY, INC.
CASE NO. 2017-00111

FIRST PSC DATA REQUEST
DATED MARCH 20, 2017

1. Provide expert testimony that includes descriptions of all schedules and work papers in its application, and an explanation of how these documents relate to one another.

Response:

a. See attached testimony of Matthew D. Wesolosky

Sponsoring Witness:

Matthew D. Wesolosky

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF AN ADJUSTMENT OF THE	**)**	
PIPE REPLACEMENT PROGRAM RIDER OF	**)**	**CASE NO. 2017-00111**
DELTA NATURAL GAS COMPANY, INC.	**)**	

DIRECT TESTIMONY OF

MATTHEW D. WESOLOSKY

March 27, 2017

Q. Please state your name and business address.

A. My name is Matthew D. Wesolosky. My business address is 3617 Lexington Road, Winchester, Kentucky, 40391.

Q. By whom and in what capacity are you employed?

A. I am employed by Delta Natural Gas Company, Inc. as its Vice President - Controller.

Q. Please describe your professional and educational background.

A. I received a Bachelor's of Science in Accounting from the University of Kentucky in 1999. I am a Certified Public Accountant in the State of Kentucky. From 1998 through 2001, I worked at Delta as the Accounting Systems Analyst/Coordinator. From 2001 through 2005 I worked in public accounting including two years at PricewaterhouseCoopers specializing in the utilities industry. From 2005 through 2007 worked at Delta as the Manager – Internal Controls. From 2007 through 2010 worked as the Manager – Accounting & IT. Beginning in 2010 I became Delta's Vice President-Controller.

Q. Generally, what are your duties with respect to Delta?

A. As Vice President – Controller, I am responsible for Delta's accounting and IT functions.

Q. Please describe your previous professional experience with Delta.

A. Prior to leading the accounting and IT functions, I was primarily responsible for the monitoring and evaluation of Delta's internal controls. I reported to and acted on behalf of Delta's Audit Committee to assist in the Committee's oversight of Delta's corporate governance. I also assisted in directing the Company's programs for compliance under Section 404 of the Sarbanes-Oxley Act of 2002 and assisted in coordination of the audit performed by our independent certified public accountants,

Deloitte. As the Accounting Systems Analyst/Coordinator, my primary responsibility was to assist in the integration of the accounting and information technology departments.

Q. Please describe your public accounting experience related to the utilities industry.

A. I was a senior associate with PricewaterhouseCoopers from 2003-2005. During this time I primarily worked on the financial audits for E.ON U.S. and its subsidiaries (Louisville Gas and Electric Company, and Kentucky Utilities Company), Western Kentucky Energy Corp. and the audit of internal controls for Southwest Power Pool. I was in charge of planning and managing the audit fieldwork as well as focusing on industry specific issues dealing with regulatory accounting, energy trading and ISO transactions.

Q. Have you testified previously before the Commission?

A. Yes, I have been a witness on behalf of Delta in the following proceedings:

Case No. 2007-00089, Application of Delta Natural Gas Company, Inc. for an Adjustment of Rates,

Case No. 2008-00062, Application of Delta Natural Gas Company, Inc, for Approval of a Customer Conservation/Efficiency Program and Demand Side Management Cost Recovery Mechanism,

Case No. 2010-00116, Application of Delta Natural Gas Company, Inc. for an Adjustment of Rates,

Case No. 2012-00136, Application for Adjustment of the Pipe Replacement Program Rider of Delta Natural Gas Company, Inc.,

Case No. 2013-00101, Application for Adjustment of the Pipe Replacement Program Rider of Delta Natural Gas Company, Inc.,

Case No. 2014-00072, Application for Adjustment of the Pipe Replacement Program Rider of Delta Natural Gas Company, Inc.,

Case No. 2015-00066, Application for Adjustment of the Pipe Replacement Program Rider of Delta Natural Gas Company, Inc., and

Case No. 2016-00110, Application for Adjustment of the Pipe Replacement Program Rider of Delta Natural Gas Company, Inc.

Q. Are you generally familiar with the business affairs of Delta?

A. Yes, I am.

Q. Please summarize the scope of your testimony.

A. My testimony provides descriptions of all schedules and workpapers in Delta's application to adjust the rates under its Pipe Replacement Program ("PRP") and explains how the documents relate to one another.

Q. Are you familiar with Delta's PRP?

A. Yes. I have prepared or have supervised the preparation of the PRPs filings since its inception.

Q. Can you explain how the PRP rates are calculated?

Yes. Schedules I through III of the PRP filing represent the detailed calculations used to derive the Current Year PRP adjustment. The Current Year PRP Adjustment includes the following:

- net PRP rate base;
- allowed PRP return, grossed up for income taxes;
- cost of service items related to PRP assets; and
- balancing adjustment for any over or under collections under the PRP tariff

The Current Year PRP Adjustment is then allocated to Delta's customer classes using the same class allocation approved in Case No. 2010-00116 based on the current number of customers.

Q. Please walk through how net PRP rate base is calculated.

A. Schedule II shows the calculation of rate base by asset class. A separate Schedule II is maintained for each vintage of PRP assets. PRP rate base consists of the investment in PRP assets, less accumulated depreciation and accumulated deferred income taxes on the respective assets.

The annual PRP investment represents amounts spent under the PRP program during the given year, inclusive of amounts in construction work-in-progress. Amounts invested in PRP assets are consistent with the PRP program as described below in an excerpt from the testimony of John B. Brown in Case No. 2010-00116:

> *Delta proposes to include in the PRP all of the planning, design, replacement construction, investment and retirement costs related to the replacement of the following categories of bare steel (whether or not cathodically protected), cathodically unprotected coated steel, and ineffectively coated steel (whether or not cathodically protected). Also, as a part of the PRP Delta proposes to include all of the planning, design, replacement construction, investment and retirement costs related to the replacement of all piping from the main to the customer's meter including curb valves, service risers, meter sets and all other related appurtenances that do not meet current material and construction standards or pose other operational issues.*

The book depreciation reserve is calculated, by asset class, using the depreciation rates approved by the Commission in Case No. 2010-00116. A half year of depreciation is used for assets in the first year. In each subsequent year, the Schedule II's are updated to reflect an additional year of depreciation.

Deferred income taxes represent the tax effect of the cumulative timing difference between book and tax depreciation. The tax depreciation reserve includes basis reductions for both tax expensing and bonus depreciation and also includes Modified Accelerated Cost Recovery System (MACRS)

depreciation. The tax effect of the cumulative timing difference is calculated using the current federal and state statutory rates, adjusted for the federal benefit of the state tax deduction.

Tax expensing represents the basis reduction for income taxes due to the difference in capitalization thresholds between book and tax. Tax expensing is calculated annually when preparing the corporate income tax return. The percentage of replacement projects which qualify for deduction as a repair expense for income taxes is applied to the total PRP investment for each asset class. The tax basis is then reduced by this amount.

Bonus depreciation is tax depreciation allowed in certain years in addition to MACRS depreciation. The percentage allowed for bonus depreciation is based on the percentage approved by Congress for the year the PRP investment was made.

The depreciable base is the residual basis in the asset after reducing the investment for tax expensing and bonus depreciation. MACRS depreciation is calculated based on the depreciable base and the MACRS rate which corresponds to the applicable tax life for the asset class and is updated annually to reflect an additional year of depreciation.

For each Schedule II included in the filing, the investment, accumulated depreciation and accumulated deferred income taxes are then reported in total on Schedule I for the given vintage of PRP assets.

Q. Can you explain why there is no tax basis for cost of removal?

A. Yes. Cost of removal is a component of rate base. As cost of removal is incurred, the cost of removal reserve decreases resulting in an increase to rate base. Cost of removal does not represent an asset and

is therefore not capitalized for income tax purposes and tax depreciation does not apply to such amounts.

Q. Please describe the cost of service items on Schedule III which are included in the PRP adjustment.

A. Cost of service items recovered through the PRP include increases in depreciation expense and property tax expense on PRP assets, offset by reductions in maintenance expense. Depreciation expense is calculated on Schedule II, as previously discussed. Increased property taxes are calculated based on the net book value of the PRP assets (as calculated on Schedule II) multiplied by the property tax rate in effect during the test year in Case No. 2010-00116. The reduction in maintenance expense is calculated as the difference between the current year maintenance expense for mains and the test year expense in Case No. 2010-00116. To the extent Delta experiences savings in maintenance expense compared with the test year, that amount is used to offset the increase in operating expenses. The total cost of service impact calculated on Schedule III is also included on Schedule I.

Q. Since inception of the PRP program, has Delta made changes to the calculation of the PRP rates?

A. In the Commission Staff's Third Data Request for Case No. 2010-00116, Item 4, Delta submitted an example of how the PRP rates would be calculated annually. The format has changed to track each vintage of PRP assets separately as well as provide more transparency in the rate base calculations. Additionally, the following formulaic changes have been made to the calculation of the PRP rates:

- Case No. 2012-00136 – The Commission approved the addition of the balancing adjustment, recovery of increased property tax expense related to PRP assets, and a provision for reduction of operation and maintenance expenses related to PRP assets.

- Case No. 2013-00101 – The Commission approved a change in the calculation of property tax expense based on the net asset value rather than the gross value.
- Case No. 2014-00072 – The Commission directed Delta to determine its PRP rate using the most current number of customers rather than the number of customers from its last general rate case.

Since 2014, there have been no further changes as to how the PRP rates are calculated.

Q. What is the purpose of Schedule IV?

A. Schedule IV was first introduced into Delta's annual PRP filing in Case No. 2013-00101. Schedule IV was created to provide the Commission with greater insight into the costs incurred on PRP assets by breaking down the cost incurred by the quantity, type and size of pipe being installed. Delta felt inclusion of this analysis in the filing would aid the Commission in its review of the PRP filing as the type and size of pipe being installed impacts the replacement cost incurred.

The quantity of pipe installed represents the quantity of pipe installed on work orders completed in the current year. The quantities are derived from the as-built drawings included in work order completion reports. The total cost incurred on Schedule IV agrees to the current year's PRP investment on Schedule I and Schedule II. As previously noted, the costs incurred are inclusive of construction work-in-progress.

Q. Please explain Schedule V.

A. Pursuant to the Commission's order in Case No. 2016-00110, Delta was asked to provide additional information in filing future PRP applications. The format and content for Items 1. a. through 1. d. were originally developed in connection with responses to data requests in Case No. 2016-00110. Schedule V sets forth the items required and their respective responses. Schedules VI through VIII provide additional information to help support the responses on Schedule V.

Item 1. d. refers to Delta's average annual main replacements of 42,000 feet per year. This amount is derived from the footage reported on Schedule IV of the PRP, less replacement projects and is calculated as follows:

	Footage per Schedule IV	Less: Mandatory Relocations	Main Replacements
2016	48,636	(10,340)	38,296
2015	33,495	(4,713)	28,782
2014	53,157	(8,078)	45,079
2013	55,975	(3,267)	52,708
2012	75,998	(2,764)	73,234
2011	26,555	(5,247)	21,308
2010	40,405	(4,822)	35,583
		average	42,141

Q. Please describe Schedule VI.

A. Schedule VI lists the feet of bare steel pipe per Delta's mapping records to be replaced through the PRP mechanism and includes bare steel and unprotected coated steel (ineffectively coated) pipe. The schedule was first created in response to Commission Staff's First Data Request in Case No. 2016-00110. The schedule shows the quantity of pipe by size in each distribution area in Delta's service territory, as well as transmission pipelines. The schedule's purpose is to estimate the quantity of pipe remaining to be replaced through the PRP.

Schedule V states, "Delta expects to reduce its mapped bare steel at a rate of 2-3 miles per year, which indicates bare steel replacement will take fourteen to twenty years to complete". The time frame of fourteen to twenty years was calculated based on the 213,210 feet of pipe reported on Schedule VI divided by 15,840 and 10,560 feet per year, respectively.

Q. How are the mapping records maintained?

A. The mapping records are maintained by Delta's engineering department in a company-developed Microsoft Access database. The mapping records are updated as work orders are completed based on the quantities reported in as-built drawings. The mapping records do not contain transactional information showing additions or replacements of pipe over a period of time, but rather shows the current quantities and type of pipe within a given location.

Q. Comparing Schedule VI in the current application to the same schedule submitted in Case No. 2016-00110 Commission Staff's First Data Request Item 2. Exhibit II, Schedule VI shows 213,210 feet of bare steel pipe to be replaced, whereas the prior year's data request showed 221,853 feet of pipe to be replaced. Does this mean that Delta only replaced 8,643 feet of pipe in 2016?

A. No. Delta replaced a total of 48,636 feet of pipe as shown on Schedule IV. Although Schedule IV shows the installed footage rather than retired quantities, there is minimal difference between the amounts physically installed versus physically retired.

Through preparation of the additional items required for the current year PRP application, Delta identified instances of misclassifications in its engineering records of pipe between bare steel and protected steel. Delta considers all bare steel and unprotected coated steel as bare steel, as both types of pipe are susceptible to the risk of corrosion. However, certain quantities of unprotected coated steel (ineffectively coated) have been categorized as protected rather than bare steel. This misclassification resulted in Delta's mapping records only showing an 8,643 decrease in bare steel pipe. Since filing the PRP application, Delta's engineering and operations personnel have undertaken a project to review the mapping records in detail and identify such misclassifications.

Q. Are the quantities on Delta's engineering records accurate?

A. The total feet of pipe in the mapping records represent actual mapped footage through as-built drawings, line walks, site surveys and aerial surveys. However, as previously noted, Delta has encountered misclassifications in the type of pipe (bare versus protected) and begun an initiative to update its records.

Q. Does this mean the amounts reported on Schedule VI are incorrect?

A. The feet of pipe reported on Schedule VI are the amounts reflected on Delta's mapping system as bare steel pipe at the time the PRP filing was prepared. However, through the initiative to review and update the mapping records additional quantities of pipe will be properly classified as bare steel. Delta expects to have its review completed by the end of calendar 2017.

Q. What is the purpose of Schedule VII?

A. Schedule VII was first prepared in response to the Case No. 2016-00110, Commission Staff's First Data Request, Item 2. d. Schedule VII describes the estimated cost per year of the PRP program by eligible activity based on the current level of effort. The footnotes to the schedule detail the assumptions used to derive the estimates or reasons for why such estimates cannot be made. The estimates on Schedule VII do not flow through to other schedules in the filing.

Q. What does Exhibit VIII show?

A. Exhibit VIII shows the feet of retired main per Delta's property accounting records by year retired, type, size and system. Exhibit VIII has not been submitted in prior applications or data responses. The quantities shown on this report are not used in any other schedule included with the filing requirements.

Q. How are Delta's accounting records maintained?

A. Delta utilizes PowerPlant to account for its fixed assets. As construction projects are completed assets are created accumulating the costs into an as-built record which allocates the cost to the type and size of pipe installed based on the work order completion report.

Q. Do the feet of pipe retired per Delta's accounting records agree with the installed footages per Schedule IV?

A. The portions of Delta's system constructed by Delta personnel contain accurate quantities of pipe; however, systems previously acquired by Delta had incomplete quantities in their accounting records. For this reason, generally, the quantities installed exceed the quantities retired within the accounting records.

Q. Please explain what you mean by incomplete quantities?

A. When pipe is retired from Delta's property accounting system, the units to be retired are selected from the taxing jurisdiction which is the lowest level of geographical detail maintained in Delta's property accounting system. There are occurrences when pipe is replaced that there are no remaining quantities to retire within a taxing jurisdiction on the property accounting system.

Q. Do retirements in Delta's accounting records agree with retirements on Delta's engineering records?

A. When a work order is completed both the mapping records and property accounting records are updated based on the quantities listed in the completion report. As previously noted, Delta's mapping system does not contain transactional data. At the time of input, the mapping records are overwritten. History of the change is not maintained by the mapping system for comparison to the accounting records.

Q. Since the retirement quantity is less than the installed quantity on the property accounting system is Delta overstating the asset balance.

A. No. Since there are no units remaining for retirement within the given taxing jurisdiction, there are also no remaining dollars associated with the taxing jurisdiction.

Q. Does this conclude your testimony?

A. Yes it does.

DELTA NATURAL GAS COMPANY, INC.
CASE NO. 2017-00111

FIRST PSC DATA REQUEST
DATED MARCH 20, 2017

2. Refer to the Application, Schedule VI. This schedule shows approximately 179,000 feet of bare steel pipe of unknown vintage.

   a. Describe any efforts Delta has undertaken to identify the vintage of this pipe.

   b. Explain whether Delta prioritizes unknown vintage pipe in its replacement program.

   c. Explain whether there is any risk in not knowing the age of the pipe.

Response:

2.

a. The bare steel pipe of unknown vintage primarily relates to systems which were acquired by Delta and not originally installed by Delta personnel. From 1990 through 2001, Delta undertook a project to digitally map its system. To create the mapping system, all work orders were reviewed from both Delta and the acquired companies. The majority of each system acquired by Delta was unmapped. To aide in the digital mapping process, Delta personnel previously employed by the acquired companies were interviewed to help develop the mapping data. Delta was able to create digital maps for these previously unmapped portions of its system. However, upon completion of the project there were still unknown vintages.

b. Delta has not historically prioritized unknown vintage pipe in its replacement program. Currently, priority has been determined by leak surveys and leak reports to determine the sections of pipe which pose the greatest risk to public safety. However, as discussed in Item 3 of this data request Delta intends to increase the number of PRP projects to target not only the pipe based on leak surveys and leak reports, but also to accelerate and systematically replace older and unknown vintage pipe.

c. Yes. There is risk to not knowing the age of the pipe; however, the use of leak surveys, leak reports and monitoring of this pipe helps to mitigate that risk by categorizing and identifying those sections of pipe which currently present risk to public safety. Delta's plans to accelerate replacement and systematically replace the unknown vintage pipe will further mitigate this risk.

Sponsoring Witness:

Matthew D. Wesolosky

DELTA NATURAL GAS COMPANY, INC.
CASE NO. 2017-00111

FIRST PSC DATA REQUEST
DATED MARCH 20, 2017

3. Refer to the Application, Schedule VI. Some of the pipe shown on this schedule has installation dates during the 1950s and 1960s. Refer also to the Application, Schedule V, part c, which states, "Delta expects to reduce its mapped bare steel at a rate of 2-3 miles per year, which indicates bare steel replacement will take fourteen to twenty years to complete." Explain if this means that some early vintage pipe may remain in the ground for 75-80 years, and whether there is an unacceptable level of safety risk associated with this.

Response:

Delta intends to continue utilizing leak surveys and leak reports to assist in monitoring of such pipe and prioritization of replacement projects under the PRP mechanism. Public safety is our highest priority and those pipe sections that need prompt attention are given priority. Given the current rate of replacement some early vintage pipe could remain in the ground for 75-80 years. This does pose a risk, but Delta mitigates that risk through maintaining this pipe by leak surveys, leak reports and monitoring of this pipe.

To further mitigate the risk, Delta intends to increase the number of PRP projects in the upcoming year allowing Delta to not only target the pipe which poses the greatest safety risk based on leak surveys, but also provide the opportunity to accelerate and systematically replace older and unknown vintage pipe so that it does not have to remain in the ground for 75-80 years. Delta is currently planning its construction efforts for the upcoming months and the amount to be accelerated has not yet been determined. However, at a minimum, Delta intends to dedicate an additional construction crew to the older and unknown vintage pipe.

Sponsoring Witness:

John B. Brown

DELTA NATURAL GAS COMPANY, INC.
CASE NO. 2017-00111

FIRST PSC DATA REQUEST
DATED MARCH 20, 2017

4. Refer to the article from Business Wire attached as an Appendix to this Order which states, "Peoples plans to increase Delta's investments in infrastructure improvement projects ... " Explain whether the referenced acquisition of Delta by Peoples Gas is expected to increase the number of projects proposed for recovery through Delta's PRP.

Response:

As stated in the press release referenced in this data request, Peoples Gas committed to provide capital investment in Delta's system to continue Delta's efforts to maintain the current pipeline system, expand it where feasible to serve unserved areas and to replace any portion as needed.

Such investment includes continuing Delta's current efforts to replace segments of pipe requiring replacement to maintain public safety. As noted in response to Item 3 of this data request, considering the quantity and age of unprotected steel pipe in its system, Delta is increasing its efforts to replace such pipe. Peoples is committed to continuing Delta's efforts and has indicated a willingness to continue to invest and to increase the investment level if necessary in such efforts after the merger. Peoples currently has an accelerated pipe replacement program approved by the Pennsylvania PUC in place for its Pennsylvania operations. Any such replacements or the request to further accelerate this pipe replacement would be included appropriately in future filings under Delta's Pipe Replacement Program.

Sponsoring Witness:

John B. Brown