

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF DELTA)	CASE NO.
NATURAL GAS COMPANY, INC. FOR ANNUAL)	2023-00343
PIPE REPLACEMENT PROGRAM)	

ORDER

On October 13, 2023, Delta Natural Gas Company, Inc. (Delta) filed an update to its pipeline replacement program (PRP) costs for the PRP year beginning January 1, 2024, and a tariff to revise the PRP rates to be effective January 1, 2024. On November 22, 2023, Commission Staff filed its first request for information to Delta. On December 4, 2023, Delta filed its responses to Staff's information requests. There are no intervenors in this case. The matter now stands submitted for a decision.

BACKGROUND

The Commission first approved Delta's PRP in Case No. 2010-00116.¹ As initially approved, the PRP provided for the accelerated recovery of the cost of replacing Delta's bare steel pipe and included replacement of service lines, curb valves, meter loops, and mandated pipe relocations. As part of Case No. 2018-00086,² the Commission approved an expansion of Delta's PRP to include the replacement of pre-1983 vintage plastic pipe with all work under the PRP to be completed by 2033.

¹ Case No. 2010-00116, *In the Matter of: Application of Delta Natural Gas Company, Inc. for an Adjustment of Rates* (Ky. PSC Oct. 21, 2010), Order.

² Case No. 2018-00086, *In the Matter of: Electronic Adjustment of the Pipe Replacement Program Rider of Delta Natural Gas Company, Inc.* (Ky. PSC Aug. 21, 2018), Order.

Delta's PRP Rider Tariff anticipates that Delta will make a PRP filing by October 5 of each year reflecting the revenue requirement impacts of PRP projects through the following calendar year that are not included in base rates with a balancing adjustment to be filed in March of each year.³ In Delta's most recent base rate case, Case No. 2021-00185, the Commission approved the roll in of PRP expenditures through December 31, 2022, into base rates and reset the PRP monthly charge to zero.⁴ Delta made a PRP filing in Case No. 2022-00341 to establish PRP rates based on the revenue requirement impact of PRP projects from January 1, 2023, through December 31, 2023.⁵

In its PRP filing in this case, Delta indicated that it was seeking to recover the revenue requirement impact of PRP projects placed in service January 1, 2023, through December 31, 2024 with rates to be effective January 1, 2024.⁶ Delta proposed a PRP revenue requirement of \$1,277,511 for the PRP period from January 1, 2024, through December 31, 2024, which it indicated was calculated based on a 13-month average rate base.⁷ Based on that revenue requirement, Delta proposed PRP rates of \$0.38927, \$0.24850, \$0.15998, and \$0.05287 per MCF for Residential, Small Non-Residential, Large Non-Residential, and Interruptible customers, respectively.⁸

³ Delta's P.S.C. No. 13, Original Sheet No. 43; see also Testimony of Jonathon Morpew (Morpew Testimony) (filed Oct. 13, 2023) at 3–4 (discussing the history of the PRP Rider).

⁴ Case No. 2021-00185, *Electronic Application of Delta Natural Gas Company, Inc. for an Adjustment of Its Rates and a Certificate of Public Convenience and Necessity* (Ky. PSC Jan. 3, 2022), Order at 21.

⁵ Case No. 2022-00341, *Electronic Application of Delta Natural Gas Company, Inc. for Its Pipe Replacement Filing* (Ky. PSC Aug. 11, 2023), Order; see also Morpew Testimony at 4.

⁶ Morpew Testimony at 4–6.

⁷ 2024_PRP_Filing.xlsx, Sch I Summary Tab (filed Oct. 13, 2023).

⁸ 2024_PRP_Filing.xlsx, Sch I Summary Tab.

In testimony submitted in support of its PRP filing, Delta's Director of Operations, Jonathon Morpew, stated that Delta plans to replace an additional 36,151 feet of pipe during the remainder of 2023 and to replace 94,243 feet of pipe in 2024 consisting of segments of bare steel and pre-1983 vintage plastic pipe.⁹ Mr. Morpew indicated that pipe sections were selected for replacement based on leak survey information, input from field personnel regarding concentrated areas of vintage piping, and input from the engineering design group regarding historic records and projects being requested by Kentucky Department of Transportation.¹⁰ Mr. Morpew stated that "[w]ith the exception of mandated Kentucky Department of Transportation relocation requirements, there were no segments of pipe that were selected to be replaced before any segments that posed a higher risk of failure."¹¹

When calculating its PRP revenue requirement, Delta applied the tax expansion factor from Case No. 2021-00185 to its full return on rate base to calculate its "[r]eturn, grossed up for income taxes."¹² In requests for information, Delta was asked to explain why it applied the tax expansion factor to the entire weighted average cost of capital (WACC) instead of just applying it to the equity portion of the WACC, and Delta stated that it did so to be consistent with its previous PRP filings.¹³ In further response to requests for information, Delta recalculated its PRP revenue requirement applying the tax

⁹ Morpew Testimony at 4-5.

¹⁰ Delta's Response to Commission Staff's First Request for Information (Staff's First Request) (filed Dec. 4, 2023), Item 1(b).

¹¹ Delta's Response to Staff's First Request, Item 1(c)

¹² 2024_PRP_Filing.xlsx, Sch I Summary Tab.

¹³ Delta's Response to Staff's First Request, Item 3(a).

expansion factor only to the equity portion of the return and it resulted in a revenue requirement that was \$96,248 lower than the revenue requirement proposed by Delta.¹⁴

LEGAL STANDARD

KRS 278.030(1) states that “[e]very utility may demand, collect and receive fair, just and reasonable rates” for utility service. Pursuant to KRS 278.509, the Commission may allow a utility to recover costs for investment in natural gas pipeline replacement programs that are not recovered in existing rates through a rider if the costs are fair, just and reasonable. The burden of proof to show that an increased rate or charge is just and reasonable shall be upon the utility.¹⁵

DISCUSSION

The evidence presented by Delta indicates that it has a process for evaluating the risk of pipe segments and that with the exception of projects required by the Kentucky Department of Transportation that it selects segments for replacement based on those risk rankings. Further, Delta indicated that the segments it chooses for replacement and inclusion in the PRP consist of bare steel and pre-1983 plastic pipe as authorized by previous cases. Thus, the Commission finds that the replacement projects included in Delta’s PRP are appropriate and consistent with Delta’s approved PRP.

The Commission does have an issue with the manner in which Delta calculated the PRP revenue requirement. Specifically, the purpose of applying the tax expansion factor is to calculate the pre-tax earnings that will give a utility the opportunity to earn its authorized return once taxes are applied. However, interest expense is generally

¹⁴ Delta’s Response to Staff’s First Request, Item 3(b).

¹⁵ KRS 278.190(3).

deductible from gross income¹⁶ such that income taxes are not generally applied to the interest portion of the return, because doing so would allow the utility to recover income tax expense from customers that it will never be required to pay. In fact, in its last application for a base rate adjustment, Delta calculated its required pretax income by grossing up only on the equity portion of its return.¹⁷

Here, Delta used the WACC approved in Case No. 2021-00185 to calculate its PRP return, but Delta grossed up both the equity and the interest portions of its return for income taxes. When asked why it grossed up the interest portion of its return for income taxes, Delta stated that it did so to be consistent with its previous PRP filings. Delta made no claim that income taxes will be applied to the interest portion of its return, and there is no evidence that income taxes will be applied to the interest portion of its return. Thus, the Commission finds that Delta failed to establish that the interest portion of its return would be subject to income taxes, and therefore further finds that Delta's gross up of the interest portion of the return for income taxes should be removed from the PRP revenue requirement.

As noted above, Delta recalculated its PRP revenue requirement applying the tax expansion factor only to the equity portion of the return and it reduced the PRP revenue requirement by \$96,248. However, the tax expansion factor of 1.33984 that Delta applied to the full return was calculated in Delta's base period update in Case No. 2021-00185

¹⁶ See, e.g. 26 U.S.C. § 163 (discussing interest deductions under the federal tax code).

¹⁷ See Case No. 2021-00185, Delta's Response to Commission Staff's First Request for Information, Item 54, DELTA_R_PSCDR1_NUM054_061121_Rate_Model_CONF.xlsx, Return Tab (filed Jun. 11, 2021) (indicating that Delta's pretax income, as filed in the application, was calculated by grossing up the equity portion of its return by the tax expansion factor filed with its application); see also Case No. 2021-00185, Application, Tab 61 (filed May 28, 2021) (indicating that the tax expansion factor used in the application was 1.3342).

based on a Bad Debt Rate/Uncollectible Expense of 0.3522 percent, a Commission Assessment Fee of 0.2000 percent, a State Income Tax Rate of 4.9724 percent, and a federal income tax rate of 19.8398 percent.¹⁸ While Delta failed to establish that the income tax rates will be applied to the interest portion of the return, other portions of the gross up likely would apply more broadly to the interest portion of the return.¹⁹ Those rates result in a gross up factor of 1.00555.²⁰ Additionally, Delta's determination of the equity portion of the return was incorrectly calculated, because it simply multiplied its return by the percentage of equity as compared to the total share of capital to determine the portion of the return attributable to equity, which did not account for the higher return on equity. Delta's methodology results in an overall pretax return of 7.868 percent.²¹ Applying Delta's tax expansion factor of 1.33984 to the weighted average cost of equity and an expansion factor of 1.00555 to the weighted average cost of debt results in pretax WACC of 8.315 percent.²² Thus, the Commission finds that Delta's PRP revenue requirement should be reduced by \$57,046 and that the total PRP revenue requirement for the 2024 PRP period should be \$1,220,465 as shown in Appendix A to this Order.

Due to the adjustment discussed above, the Commission finds that the PRP rates proposed by Delta to be effective January 1, 2024 are not fair, just, and reasonable. Rather, the Commission finds that the rates should be recalculated based on the adjusted

¹⁸ Case No. 2021-00185, DELTA_BPU_TAB61_ATT_101421.xlsx (filed Oct. 14, 2021).

¹⁹ See, e.g. KRS 278.150 (indicating that the Commission assessment is more broadly applicable).

²⁰ $1 / 0.994478 = 1.00555$.

²¹ $689,544 / 8,764,226 = 7.868$ percent.

²² Delta's Response to Staff's First Request, Item 3(b); see also Appendix A to this Order for the calculation of the pretax WACC.

PRP revenue requirement discussed above but without any changes to the cost allocation or the rate design. Doing so, using the spreadsheets provided by Delta, results in PRP rates of \$0.37189, \$0.23741, \$0.15284, and \$0.05051 per MCF for Residential, Small Non-Residential, Large Non-Residential, and Interruptible customers, respectively, as shown in Appendix A to this Order. Thus, the Commission finds that those rates, which are shown in Appendix B to this Order, are fair, just and reasonable, and should be approved.

IT IS THEREFORE ORDERED that:

1. The PRP rates proposed by Delta are denied.
2. The PRP rates in Appendix B to this Order are approved for service rendered on and after January 1, 2024.
3. Delta shall file its next annual PRP filing with the Commission no later than October 15, 2024.
4. Within 20 days of the date of service of this Order, Delta shall file with the Commission using the Commission's electronic Tariff Filing System, revised tariff sheets setting out the rates approved herein and reflecting that they were approved pursuant to this Order.
5. This case is closed and removed from the Commission's docket.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ENTERED
DEC 22 2023 bsb
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

 Folk
Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2023-00343 DATED DEC 22 2023

	2023	2024	Total
1 Planned eligible expenditures under the PRP (Schedule II)	\$ 8,456,789	\$ 3,560,648	
2 Less:			
3 Accumulated depreciation	(383,505)	(53,396)	
4 Accumulated deferred income taxes	(1,941,250)	(875,059)	
5 Net PRP Rate Base, as of December 31, 2024	6,132,034	2,632,193	
6 WACC, per case no 2021-00185	6.692%	6.692%	
7 WACC, grossed up for income taxes, PSC assessment, and bad debt	8.315%	8.315%	
8 Allowed Return	509,879	218,867	
9 Return, grossed up for income taxes			\$ 728,746
10 Cost of Service Items (Schedule III)			\$ 491,719
11 Current Year PRP Adjustment			\$ 1,220,465

	Calculated Net Revenue @ Approved Rates per Case No. 2021-00185	Class Allocation	Allocated PRP Adjustment	Volumes for the 12 months ended July 31, 2021	PRP Rate Per MCF
12 Residential	\$ 17,392,991	51.4%	\$ 627,238	1,686,614	\$ 0.37189
13 Small Non-Residential	5,243,155	15.5%	\$ 189,082	796,451	\$ 0.23741
14 Large Non-Residential	9,236,757	27.3%	\$ 333,102	2,179,457	\$ 0.15284
15 Interruptible	1,969,984	5.8%	\$ 71,043	1,406,651	\$ 0.05051
16 Total	\$ 33,842,887	100.0%	\$ 1,220,465	6,069,173	

	Weighted Cost of Capital	Gross Revenue Conversion Factor	Pretax Weighted Average Cost of Capital
Equity	4.7445%	1.33984	6.3569%
Long-term debt	1.9296%	1.00555	1.9404%
Short-term Debt	0.0176%	1.00555	0.0177%
Total	6.6917%		8.3150%

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2023-00343 DATED DEC 22 2023

The following rates and charges are prescribed for the customers in the area served by Delta Natural Gas Company, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under the authority of the Commission prior to the effective date of this Order.

Pipeline Replacement Program Rates per Mcf:

Residential	\$ 0.37189
Small Non-residential	\$ 0.23741
Large Non-residential	\$ 0.15284
Interruptible	\$ 0.05051

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