



COMMONWEALTH OF KENTUCKY
OFFICE OF THE ATTORNEY GENERAL

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August 23, 2004

RECEIVED

AUG 23 2004

**PUBLIC SERVICE
COMMISSION**

Ms. Beth O'Donnell
Executive Director
Kentucky Public Service Commission
211 Sower Blvd.
Frankfort, KY. 40601

RE: In the Matter of: Application of Delta Natural Gas Company for an Adjustment of Rates, PSC Case No. 2004-00067/Response to Staff's Data Request at Hearing

Dear Ms. O'Donnell:

Please find enclosed the Attorney General's Response to the staff's Data Request made at the hearing in the above-captioned matter on August 18, 2004. Specifically, the Attorney General was requested to supply his revised position on the revenue deficiency of Delta Natural Gas as offered through the testimony of Robert J. Henkes when reflecting the 10.30% Return on Equity recommended by Charles King. As seen on Schedule RJH-1, that change results in a recommendation that Delta Natural Gas Company has a revenue deficiency of no more than \$1,536,110.

For the Commission's convenience, I supply revised copies of all of Mr. Henkes' schedules. Please contact me if further clarification is necessary. I thank you in advance for your attention in this matter.

Sincerely,

A handwritten signature in black ink, appearing to read "Dennis G. Howard, II".

Dennis G. Howard, II
Acting Director

cc: Parties of record

Enclosures

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**DELTA NATURAL GAS COMPANY
 SUMMARY OF REVENUE REQUIREMENT POSITIONS**

	<u>Delta</u> (1)	<u>Adjustments</u>	<u>AG</u>	
1. Rate Base	\$ 111,071,658	\$ 680,287	\$111,751,945	Sch. RJH-3
2. Rate of Return	<u>8.549%</u>		<u>7.732%</u>	Sch. RJH-2
3. Income Requirement	9,496,008		8,641,094	
4. Pro Forma Income	<u>6,905,785</u>	806,813	<u>7,712,598</u>	Sch. RJH-5
5. Income Deficiency	2,590,223		928,496	
6. Revenue Conversion Factor	<u>1.6513912</u>		<u>1.6544073</u>	(2)
7. Revenue Deficiency	<u>\$ 4,277,471</u>	<u>\$ (2,741,361)</u>	<u>\$ 1,536,110</u>	

(1) FR 10(7)(a) and Delta filing Schedules 1, 7, 8 and 9.

	<u>Delta</u>	<u>AG</u>	
(2) Revenues	100.0000000	100.0000000	
Less: PSC Fees	<u>-</u>	(0.1823000)	(3)
	100.0000000	99.8177000	
Less: State Income Tax @ 8.25%	<u>(8.2500000)</u>	(8.2349603)	
	91.7500000	91.5827398	
Less: Federal Income Tax @ 34%	<u>(31.1950000)</u>	(31.1381315)	
Net Income Factor	60.5550000	60.4446082	
Revenue Conversion Factor	<u>1.6513912</u>	<u>1.6544073</u>	

(3) Response to PSC-3-25

**DELTA NATURAL GAS COMPANY
 ADJUSTED CAPITALIZATION AT 12/31/03 AND OVERALL RATE OF RETURN**

<u>DELTA PROPOSED:</u>	<u>Adjusted Actual 12/31/03 Capitalization</u> (1)	<u>Capitalization Ratios</u>	<u>Cost Rates</u>	<u>Weighted Cost Rates</u>
1. Equity	\$ 42,865,046	37.15%	12.500%	4.643%
2. Long Term Debt	54,824,000	47.51%	7.422%	3.526%
3. Short Term Debt	<u>17,707,889</u>	<u>15.35%</u>	2.478%	<u>0.380%</u>
4. Total	<u>\$ 115,396,935</u>	<u>100.00%</u>		<u>8.549%</u>

<u>AG RECOMMENDED:</u>	<u>Adjusted Actual 12/31/03 Capitalization</u> (1)	<u>Capitalization Ratios</u>	<u>Cost Rates</u>	<u>Weighted Cost Rates</u>
1. Equity	\$ 42,865,046	37.15%	10.300% (2)	3.826%
2. Long Term Debt	54,824,000	47.51%	7.422%	3.526%
3. Short Term Debt	<u>17,707,889</u>	<u>15.35%</u>	2.478%	<u>0.380%</u>
4. Total	<u>\$ 115,396,935</u>	<u>100.00%</u>		<u>7.732%</u>

(1) Delta filing Schedule 9

(2) Testimony of Charly King

**DELTA NATURAL GAS COMPANY
 RATE BASE**

	<u>Delta</u> (1)	<u>Adjustments</u>	<u>AG</u>	
1. Plant in Service	\$ 165,994,418		\$ 165,994,418	
2. Depreciation Reserve	<u>(52,964,026)</u>		<u>(52,964,026)</u>	
3. Net Plant in Service	113,030,392		113,030,392	
4. Cash Working Capital	1,290,427	(40,017)	1,250,410	Sch. RJH-4
5. Prepayments	351,876	(39,440) (2)	312,436	
6. Materials and Supplies	478,139		478,139	
7. Gas in Storage	6,363,748		6,363,748	
8. Accum. Def. Income Taxes	(14,697,866)		(14,697,866)	
9. Unamortized Debt Expense	4,185,070		4,185,070	
10. Advances in Construction	(105,692)		(105,692)	
11. Depreciation Adjustment	145,431	759,744	905,175	Sch. RJH-14, L5
12. Unrecovered SFAS 143 Costs	<u>30,133</u>		<u>30,133</u>	
13. TOTAL NET RATE BASE	<u>\$ 111,071,658</u>	<u>\$ 680,287</u>	<u>\$ 111,751,945</u>	

(1) Delta filing Schedule 7

(2) Per response to AG-1-5. Remove KPSC assessments from prepayment balance.

**DELTA NATURAL GAS COMPANY
CASH WORKING CAPITAL**

	<u>Delta</u>	<u>Adjustments</u>	<u>AG</u>	
	(1)			
1. Pro Forma O&M Expenses	\$ 10,323,416	\$ (320,132)	\$ 10,003,284	Sch. RJH-5, L3
2. CWC Ratio	<u>0.125</u>		<u>0.125</u>	
3. Cash Working Capital	<u>\$ 1,290,427</u>	<u>\$ (40,017)</u>	<u>\$ 1,250,410</u>	

(1) Delta filing Schedule 1, line 2 and Schedule 7, line 4

**DELTA NATURAL GAS COMPANY
 PRO FORMA OPERATING INCOME**

	<u>Delta</u> (1)	<u>Adjustments</u>	<u>AG</u>	
1. Operating Revenues	\$ 57,709,948	\$ 239,331	\$ 57,949,279	Sch. RJH-6A, L4
<u>Operating Expenses:</u>				
2. Purchased Gas Cost	33,364,884		33,364,884	
3. O&M Expenses	10,323,416	(320,132)	10,003,284	Sch. RJH-7
4. Depreciation	4,045,073	(759,744)	3,285,329	Sch. RJH-14, L3
5. Other Taxes	<u>1,505,464</u>	<u>4,263</u>	<u>1,509,727</u>	(2)
6. Operating Exp. w/o Income Tax	49,238,837	(1,075,613)	48,163,224	
7. Income Taxes	<u>1,565,326</u>	<u>508,131</u>	<u>2,073,457</u>	Sch. RJH-15
8. Total Operating Expenses	<u>50,804,163</u>	<u>(567,482)</u>	<u>50,236,681</u>	
9. Operating Income [L1 - L8]	<u>\$ 6,905,785</u>	<u>\$ 806,813</u>	<u>\$ 7,712,598</u>	

(1) FR 10(7)(a)

(2) Response to PSC-3-12 b., page 4 of 9, revised filing Schedule 6. Adjustment is for Bonus Taxes.

DELTA NATURAL GAS COMPANY
NET REVENUE ADJUSTMENT FOR TEST YEAR-END CUSTOMER GROWTH
[METHOD I]

	1	2	3	4	5	6	7	8	9	10
	Test Yr. Customers 12/31/03	Test Yr. Customers 13-mos Avg	12/31/03 vs. Avg Growth	Annual Cust. Charge	Add'l Cust. Ch. Rev.	Test Yr. MCF Sales	Avg. Sales Per Cust.	Cons. Base Rate per MCF	Add'l MCF Usage Charge Rev.	Total Incremental Revenues
	(a)	(b)	[1 - 2]	(c)	[3 x 4]	(d)	[6 / 2]	(e)	[3 x 7 x 8]	[5 + 9]
1. Residential	34,100	33,759	341	\$ 96.00	\$ 32,736	2,316,920	68.63	\$ 3.6224	\$ 84,776	
2. Small Non-Residential	4,629	4,491	138	\$ 204.00	\$ 28,152	702,702	156.47	\$ 3.5800	\$ 77,302	
3. Large Non-Residential	872	868	4	\$ 600.00	\$ 2,400	987,090	1,137.20	\$ 3.0700	\$ 13,965	
4. Revenue Adjustment					\$ 63,288				\$ 176,043	\$ 239,331
5. Associated Incremental Costs at Operating Ratio of 12.40% (f):										(29,677)
6. Recommended Net Incremental Revenues										\$ 209,654

- (a) Responses to PSC-1-44, p.2 and AG-1-30, p. 6 of 6
 (b) Calculated from responses to PSC-1-44 and AG-1-30. Confirmed in response to AG-1-32.
 (c) Delta's present tariffs, e.g., monthly residential customer charge of \$8.00 is annual charge of 12 x \$8.00, or \$96.00.
 (d) Delta filing Schedule 2 & 3
 (e) Delta's present tariffs. The usage rates for Small Non-Residential (\$3.58) and Large Non-Residential (\$3.07) represent weighted average rates based on weighting factors used by Delta in its prior Case No. 899-176 on Walker Exhibit 5.

(f) Operating Ratio Calculation:

- Test Year per books O&M expenses excluding cost of gas:	\$ 10,548,848
- Less: Payroll expenses [Hall WP-4.1]	(4,683,924)
- Less: Employee pensions and benefits [2003 FERC Form 1, p. 323]	(2,716,909)
- Less: Regulatory commission expense [2003 FERC Form 2, p.323]	(143,222)
- Net O&M expenses	\$ 3,004,793
- 2003 per books revenues net of GCR revenues [Delta filing Sch. 2 & 3]	\$ 24,229,318
- Operating Ratio [net O&M expense/revenues net of GCR]	12.40%

DELTA NATURAL GAS COMPANY
NET REVENUE ADJUSTMENT FOR TEST YEAR-END CUSTOMER GROWTH
[METHOD II]

	1	2	3	4	5	6	7	8	9	10
Test Yr. Customers 13-mos Avg	1/2 Yr Compound Growth Rate	1/2 Yr Cust. Growth	Annual Cust. Charge	Add'l Cust. Ch. Rev.	Test Yr. MCF Sales	Avg. Sales Per Cust.	Cons. Base Rate per MCF	Add'l MCF Usage Charge Rev.	Total Incremental Revenues	
(a)	(b)	[1 x 2]	(c)	[3 x 4]	(d)	[6 / 1]	(e)	[3 x 7 x 8]	[5 + 9]	
1. Residential	33,759	0.505%	170.5	\$ 96.00	\$ 16,366	2,316,920	68.63	\$ 3,6224	\$ 42,384	
2. Small Non-Residential	4,491	0.875%	39.3	\$ 204.00	\$ 8,016	702,702	156.47	\$ 3,5800	\$ 22,012	
3. Large Non-Residential	868	0.265%	2.3	\$ 600.00	\$ 1,380	987,090	1,137.20	\$ 3,0700	\$ 8,030	
4. Revenue Adjustment				\$ 25,763				\$ 72,426	\$ 98,189	
5. Associated Incremental Costs at Operating Ratio of 12.40% (f):									(12,175)	
6. Recommended Net Incremental Revenues									\$ 86,014	

(a) Calculated from responses to PSC-1-44 and AG-1-30. Confirmed in response to AG-1-32.

(b) Calculation of 1/2 yr. compound growth rate:

	Response to AG-1-30 - # of Customers	
	Avg. Res.	Avg. Large Non-Res.
1998	32,111	4,118
1999	32,785	4,249
2000	33,609	4,386
2001	33,696	4,437
2002	33,756	4,458
2003	33,759	4,491
5-Yr. compound annual growth rate	1.01%	1.75%
1/2 of compound annual growth rate	0.505%	0.875%
		NA
		849
		859
		868
		875
		868
		0.53%
		0.265%

(c) Delta's present tariffs, e.g., monthly residential customer charge of \$8.00 is annual charge of 12 x \$8.00, or \$96.00.

(d) Delta filing Schedule 2 & 3

(e) Delta's present tariffs. The usage rates for Small Non-Residential (\$3.58) and Large Non-Residential (\$3.07) represent weighted average rates based on weighting factors used by Delta in its prior Case No. 899-176 on Walker Exhibit 5.

(f) For operating ratio calculation, see footnote (f) on Schedule RJH-

**DELTA NATURAL GAS COMPANY
ADJUSTED OPERATION AND MAINTENANCE EXPENSES**

1. Adjusted O&M Expenses Proposed by Delta	\$ 10,323,416	(1)
<u>AG-Recommended O&M Expense Adjustments:</u>		
2. Expense Increase Associated With Cust. Growth Rev. Adj.	29,677	Sch. RJH-6A, L5
3. Remove Interest on Customer Deposits	(33,554)	(1)
4. Adjustment to Bonus Removal	86,000	(2)
5. 401(k) Expense Adjustment	18,456	Sch. RJH-8
6. Rate Case Expense Adjustment	(45,833)	Sch. RJH-9
7. Directors Fees and Expense Adjustment	(52,126)	Sch. RJH-10, L4
8. Outside Services - Accounting Expense Adjustment	(163,328)	Sch. RJH-11
9. Outside Services - Computer Expense Adjustment	(42,404)	Sch. RJH-12
10. Miscellaneous Expense Adjustments	(87,343)	Sch. RJH-13
	<hr/>	
11. Total AG-Recommended O&M Expense Adjustments	(320,132)	
12. Adjusted O&M Expenses Recommended by AG	<u>\$ 10,003,284</u>	

(1) Delta filing Schedule 4

(2) Response to PSC-3-12 b., page 2 of 9, revised filing Schedule 4: Bonus removal of \$317,865 vs. \$403,865.

**DELTA NATURAL GAS COMPANY
401(K) EXPENSES**

	<u>Delta</u> (1)	<u>Adjustments</u>	<u>AG</u>	
1. 401(k) Costs	\$ 132,894	\$ 23,833	\$ 156,727	(2)
2. O&M Expense Ratio		<u>77.44%</u>		(3)
3. 401(k) Expense Increase		<u>\$ 18,456</u>		

(1) Responses to PSC-1-20 b. and PSC-1-46, line 11.

(2) Response to PSC-1-25 aa and PSC-3-12 d.

(3) Response to AG-2-10 c.

**DELTA NATURAL GAS COMPANY
RATE CASE EXPENSES**

	<u>Delta</u> (1)	<u>Adjustments</u>	<u>AG</u>
1. Current Rate Case Expense Claim	\$ 250,000		\$ 150,000
2. Amortization Period (Yrs)	<u>3</u>		<u>4</u>
3. Annual Expense Amortization	<u>\$ 83,333</u>	<u>\$ (45,833)</u>	<u>\$ 37,500</u>

(1) Hall WP-4.2

**DELTA NATURAL GAS COMPANY
DIRECTORS FEES AND EXPENSES**

1. Delta's Proposed Test Year Directors Fees and Expenss	<u>\$ 225,369</u> (1)
<u>AG-Recommended Adjustments:</u>	
2. Remove Non-Recurring Directors Bonuses	(51,440) (2)
3. Remove Christmas dinner and Christmas gift expenses	<u>(686)</u> (3)
4. Total AG Expense Adjustments	<u>(52,126)</u>
5. AG-Recommended Outside Services - Accounting Expenses	<u>\$ 173,243</u>

(1) Responses to PSC-1-20 b.

(2) Response to AG-1-9

(3) Response to PSC-2-25 cc.: $\$349 + \$337 = \$686$

**DELTA NATURAL GAS COMPANY
OUTSIDE SERVICES - ACCOUNTING EXPENSES**

1. Test Year Per Books Outside Services - Accounting Expenses Reflected by Delta	\$ 343,748 (1)
<u>AG-Recommended Adjustments:</u>	
2. Remove Non-Recurring Sarbane/Oxley Related Expenses	(163,328) (2)
3. AG-Recommended Outside Services - Accounting Expenses	<u>\$ 180,420</u>

(1) Response to PSC-1-20 b.

(2) Response to AG-1-48

**DELTA NATURAL GAS COMPANY
OUTSIDE SERVICES - COMPUTER EXPENSES**

1. Test Year Per Books Outside Services - Computer Expenses Reflected by Delta	\$ 155,951 (1)
<u>AG-Recommended Adjustments:</u>	
2. Remove Non-Recurring Scanning Service Expenses	(42,404) (2)
3. AG-Recommended Outside Services - Computer Expenses	<u>\$ 113,547</u>

(1) Response to PSC-1-20 b.

(2) Responses to PSC-2-36 g. and PSC-1-28 (Source Imaging Scanning Services)

**DELTA NATURAL GAS COMPANY
 MISCELLANEOUS EXPENSE ADJUSTMENTS**

1. Removal of Additional Lobbying Expenses	\$	(758)	(1)
2. Remove AGA Dues Associated with Public Affairs and Institutional Advertising		(7,389)	(2)
3. Removal of Incentive Expenses in Acct. 930.110		(44,200)	(3)
4. Removal of Expenses for Employee Gifts and Award Banquets, Social Events and Parties		(19,886)	(4)
5. Removal of Promotional and Economic Development Expenses Included in Acct. 930.090		(4,914)	(5)
6. Removal of Certain Employee Membership Exp. in Acct. 921.070		(2,749)	(6)
7. Removal of Spousal Expenses from Acct. 921.21		(264)	(7)
8. Removal of Lobbying and Econ. Devel. Exp. From Acct. 921.220		(5,161)	(8)
9. Removal of Lobbying and Community Relations Exp in Acct 921.29		<u>(2,022)</u>	(9)
10. Total Miscellaneous Expense Adjustments	<u>\$</u>	<u>(87,343)</u>	

- (1) Per response to AG-1-37: total test year lobbying expense of \$16,821 vs. \$16,083 of test year lobbying expense removed by Delta on filing Schedule 4 (\$15,280 + \$783)
- (2) Per response to AG-1-39: test year AGA dues of \$27,277 x 27.09% for public affairs (25.63%) and advertising (1.46%)
- (3) Response to AG-1-43
- (4) Response to AG-1-26
- (5) Per response to AG-1-42: removed expenses in line items 5, 27, 31-33, 35, 42, 45, 47, and 49.
- (6) Per response to AG-1-45 a.: removed expenses for check nos. 212155, 216763, 214857, 216453, 215708, 213811, 200671
- (7) Response to PSC-3-23
- (8) Per response to AG-1-45 b.: removed expenses in acct. 921.220 line items 29-35, 43, 55-56, 62.
- (9) Per response to AG-1-45 c.: removed expenses in acct. 921.29 line items 162, 216, 232, 234, 243, 248, 251, 258, 284-285, 288, 295, 299, 302, 321, 330, 351.